SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL., PETITIONERS,

vs.

MID-CONTINENT PETROLEUM CORPORATION.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

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IN UNITED STATES DISTRICT COURT FOR THE DISTRICT OF KANSAS, THIRD DIVISION

Pleas and proceedings before The Honorable Richard J. Hopkins, Judge of the United States District Court for the District of Kansas, presiding in the following-entitled cause:

Equity. No. 337-N

ANNIE SAUDER, Administratrix of the Estate of Philip Sauder, Deceased, et al., Plaintiffs,

vs.

MID-CONTINENT PETROLEUM CORPORATION, a Corporation, Defendant

IN DISTRICT COURT OF GREENWOOD COUNTY, KANSAS

PHILIP SAUDER, Plaintiff,

vs.

MID-CONTINENT PETROLEUM CORPORATION, a Corporation, Defendant

No. 15292

PETITION—Filed June 27, 1930

Comes now the plaintiff, Philip Sauder, and for his cause of action against the defendant above named, alleges and shows the court that he is an actual bona fide resident of Greenwood County, Kansas, and that his true and correct post office address is Gridley, Kansas.

Plaintiff further alleges that he is the owner in fee simple of the following described real estate lying and situate in the County of Greenwood and State of Kansas, to-wit:

The East Half and the Southeast Quarter of the Southwest Quarter of Section 16, Township 23, Range 13, containing 360 acres more or less.

Plaintiff further alleges that heretofore and upon the 6th day of June, A. D. 1916, he made, executed and delivered to W. A. Moon and J. W. Phillips his certain oil and gas lease, in writing, of that date, by the terms of which he leased said land for gas and oil. A copy of said lease is attached hereto marked Exhibit A, and is hereby made a part of this petition as fully as though written in at this place in full.

[fol. 2] Plaintiff further alleges and shows the court that thereafter and upon August 9, 1917, said Moon and Phillips duly assigned said lease to Atlantic Petroleum Corporation and said assignment is of record in the office of the Register of Deeds of Greenwood County, Kansas, in Book 2 of Assignments at Page 241. That thereafter and upon February 24, 1925, said Atlantic Petroleum Corporation duly assigned said lease to Cosden & Company and said assignment is of record in the office of said Register of Deeds in Book CC of Miscellaneous records at page 325.

That thereaf-er, but plaintiff can not give the exact date, said Cosden & Company became the Mid-Continent Petroleum Corporation, and said Mid-Continent Petroleum Corporation became and is the owner of said lease.

The said Mid-Continent Petroleum Corporation, defendant above named, is a Delaware Corporation with its post office and place of business at Tulsa, Oklahoma, and is authorized to do business in the State of Kansas as such corporation.

Plaintiff further alleges and shows the court that thereafter and on or about the 1st day of November, 1921, the said defendant, Mid-Continent Petroleum Corporation, completed a well in accordance with the terms of said oil and gas lease Exhibit A, upon the Southeast quarter of the Southwest Quarter of said Section 16, and that oil and gas were found therein in paying quantities. Said plaintiff further alleges and shows the court that thereafter and on or about the 1st day of January, 1922, said defendant, Mid-Continent Petroleum Corporation, completed another well upon said Southeast Quarter of the Southwest Quarter of said Section 16, and found therein oil in paying quantities; that aside from said two wells above described, during all the years intervening since the date of said lease, no effort has been made and no act performed by said defendant, Mid-Continent Petroleum Corporation, or any other holder

or owner of said lease, toward the development of said real estate described above for oil and gas. No well has been drilled, no locations made, no effort whatever has been put forth by said defendant, Mid-Continent Petroleum Corporation, to explore for oil and gas or to develop said land for oil and gas; that on or about the 1st day of Jan-
[fol. 3] uary, 1922, for the purpose of pumping the two wells above herein described, the said defendant located and erected upon said Southeast Quarter of the Southwest Quarter of Section 16, a power plant; that until the year 1927, the exact time the plaintiff is unable to state, said two wells were pumped by power furnished by said power plant located on said Southeast Quarter of the Southwest Quarter of Section 16, but that thereafter, and about the month of September, 1927, the said defendant, Mid-Continent Petroleum Corporation, removed said power plant and procured power for the pumping of said two wells from an adjacent leasehold operated by said defendant, and is still so procuring power for that purpose.

Plaintiff further alleges that on or about the 11th day of December, 1924, the exact date the plaintiff cannot state, plaintiff demanded of the then owners of said lease and predecessors of Mid-Continent Petroleum Corporation, that they proceed with the development and exploration of said real estate above described for gas and oil; that said demand was upon one Harry George, who at the time was District Supt. for the Cosden and Company and The Atlantic Petroleum Corporation, predecessors of said Mid-Continent Petroleum Corporation, in charge of this and other property in Greenwood County, and Woodson County, Kansas. Said plaintiff made similar demands at various times from the date of said lease until 1928, on various employees and agents of said holders of said lease, but is unable to state names or dates.

Plaintiff further alleges and shows the court that on the 16th day of June, 1926, plaintiff wrote a letter to the said defendant, Mid-Continent Petroleum Corporation, calling attention to the fact that no work had been done toward the exploration or development of any of the property herein described, except said Southeast Quarter of the Southwest Quarter of said Section 16, and demanding that development proceed, and if said Mid-Continent Petroleum Corporation did not intend to develop said land that the said

lease should be cancelled by said Mid-Continent Petroleum Corporation. A copy of said letter is hereto attached marked Exhibit B and made a part of this petition. That shortly thereafter this plaintiff received a letter from said Mid-Continent Petroleum Corporation, in which the said Mid-Continent Petroleum Corporation stated that it considered said lease a valuable one and that it would not cancel the same. A copy of said letter is hereto attached [fol. 4] marked Exhibit C, and made a part of this petition. Plaintiff further alleges and shows the court that no effort has since that time been made and no act performed toward the development of said leased premises or any part thereof.

Plaintiff further alleges and shows the court that there is oil development upon land adjacent to the land in question as follows: That on the half section of land immediately east of said half section owned by plaintiff, there are now 25 producing oil wells producing oil in good paying quantities; that upon the quarter section of land immediately north of the Northeast Quarter of said Section 16, there is a producing oil well; that upon the North Half of the Southwest Quarter of said Section 16, lying immediately west of plaintiffs' land, there are 3 oil wells, producing oil in paying quantities, and one dry hole has been drilled upon said 80 acres of land; that upon a 40 acre tract of land, being the Southwest Quarter of the Southwest Quarter of said Section 16, there are three producing oil wells and no dry wells; that upon the North Half of Section 21, lying immediately south of the said Section 16, there are 15 producing oil wells producing oil in paying quantities and only one dry hole; that upon the Northwest Quarter of Section 22, lying immediately south and east of said Section 16 and cornering with the plaintiffs' land, there are 12 producing oil wells, producing oil in paying quantities and no dry holes has been drilled upon said property. That from the oil wells upon adjacent land, although none are closer than four hundred feet from plaintiffs' line, several are close enough, that plaintiff is informed and verily believes and therefore alleges that there is grave danger that oil deposits, if any, under the land of this plaintiff, will be drawn off or depleted by the pumping of oil upon adjacent land; that said oil production upon adjacent land has been going on for a number of years and that no

new wells have drilled upon said adjacent land since the year 1922.

Plaintiff further alleges that under the terms of said lease it was the duty of the holders thereof and especially of the defendant, Mid-Continent Petroleum Corporation, to fully explore and develop said lands for oil and gas, and plaintiffs allege that during the past years and ever since June 6, 1916, the said defendant, Mid-Continent Petroleum [fol. 5] Corporation, and all of the parties to whom said lease may have been assigned have wholly failed, refused, and neglected to develop said land for oil and gas with the single exception of the two wells hereinbefore mentioned on the Southeast Quarter of the Southwest Quarter of said Section 16 and adjacent to the Southwest corner of said Half Section herein described belonging to plaintiff; that no effort whatever has been made to explore the east half of said Section 16, that the said defendant, Mid-Continent Petroleum Corporation, although repeatedly requested and demanded so to do, as hereinbefore stated, has wholly refused and failed to further develop said land for gas and oil.

Plaintiff further alleges that since the year 1922, at least the development of oil upon land adjacent to the land described herein belonging to plaintiffs has made it practically certain that oil could have been discovered in paying quantities by the drilling of wells upon said East Half of said Section 16, but that notwithstanding said fact, the said defendant, Mid-Continent Petroleum Corporation, has refused to develop said land and has held the same for speculative purposes and that by reason of such refusal said defendant, Mid-Continent Petroleum Corporation in equity and good conscience, has forfeited its right to further hold said lease and should be by this court adjudged and decreed to be wholly in default of its obligations under the terms of said lease, and said lease should be by the court cancelled, set aside and held for naught as to all of said land described herein, with the possible exception of land immediately adjacent to the two wells heretofore described lying and situate in the South part of the Southeast Quarter of the Southwest Quarter of said Section 16.

Plaintiff further alleges that unless said lease be cancelled, by this court, said defendant, Mid-Continent Petroleum Corporation, will continue to hold said lease for

speculative purposes and thereby plaintiffs will be deprived of the very objects, purposes, and things which were the consideration for the execution of said oil and gas lease in the first instance.

Wherefore, the premises considered, plaintiff prays for a judgment and decree of this honorable court, cancelling said lease and that said lease be cancelled, set aside and held for naught as to all of said lands, except such portion [fol. 6] of said Southeast Quarter of the Southwest Quarter of said Section 16, immediately adjacent to said two wells described in the petition herein, as the court may designate and plaintiff prays that he may have such other, further and additional relief as he may be entitled to receive in equity and good conscience, including his costs herein expended.

Ray S. Pierson, W. L. Huggins, Attorneys for Plaintiff. Elwin Ware, of Counsel.

[File endorsement omitted.]

EXHIBIT A TO PETITION

Oil and Gas Lease

This Agreement, Made and entered into this 6th day of June, A. D. 1916, by and between Philip Sauder, Annie Sauder, his wife of Greenwood County, State of Kansas, parties of the first part, and W. A. Moon and J. W. Phillips, parties of the second part:

Witnesseth: That the said parties of the first part in consideration of the sum of $1.00 (one) Dollars, receipt of which is hereby acknowledged to them duly paid by the said parties of the second part, and of the covenants and agreements hereinafter contained on the part of the said parties of the second part, to be kept and performed, do hereby Lease and Let unto the said parties of the second part the exclusive right for Ten Years from date hereof, and as long thereafter as Oil or Gas can be procured thereon in paying quantities, to enter upon, operate for and procure Oil and Gas upon the following described premises, situated in Greenwood County, State of Kansas, to-wit East ½ of Sec. 16 Town. 23 Range 13 Acres 320. South-

east ¼ of Southwest ¼ Sec. 16 Town. 23 Range 13 Acres 40,

The Parties of the second part agree to deliver to the parties of the first part one-eighth of the Oil realized from these premises, in tanks at the wells without cost, or pay the market price therefor, in cash, at the option of the first parties. If Oil or Gas be found on these premises by said second parties, all rights, benefits, and obligations secured [fol. 7] hereby shall continue so long as either can be procured in paying quantities.

If sufficient gas is found in any well or wells producing gas only, on said premises, to justify the expenses of saving and casing same, said first parties to have on demand, sufficient gas from such well or wells, free of cost at such well or wells for domestic purposes on said premises, the second parties to have the remainder thereof, with free gas or oil for drilling and operating all machinery. If, however, second parties shall market or sell gas from any well producing gas only, it shall pay said first parties or assigns therefor $100.00 (One Hundred Dollars) per year for and during such time gas shall be sold or marketed, said payment to be made on each well within sixty days after commencing to sell gas therefrom, and annually thereafter, while such gas is sold or marketed from such well or wells.

Second parties agree to locate all wells so as to interfere as little as possible with the cultivated portion of the premises, and pay all damages by reason of its operation, and not to locate any well or wells within 200 feet of any building on said premises. The said second parties shall have the privilege of using sufficient water from any creek, branch, lake, or pond on said premises, and if necessary to drill therefor, or make ponds, to run all necessary machinery for drilling and prospecting for oil and gas and operating same.

In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. Provided, however, that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance.

The said second parties shall have the exclusive right to erect, lay and maintain upon said premises all pipe, pipe line, machinery and structure necessary for the production, preservation or transportation of Oil and Gas, or either of them, and to remove therefrom such pipes, pipe lines, machinery and other structures. And second parties shall [fol. 8] have the right to discharge any incumbrance on said premises and shall have a lien thereon for the amount so paid, together with all the costs and expenses incurred.

And the said parties of the first part do covenant and agree that at the delivery hereof they are the lawful owners of the premises above granted and seized of a good and indefeasible state of inheritance therein, free and clear of all incumbrance, except a Mortgage of $8000.00.

This Contract Shall extend to and be binding upon the heirs, assigns, successors and personal representatives of the parties hereto. Executed in duplicate the day and year first above written.

Witnesses: Philip Sauder, Annie Sauder, W. A. Moon, J. W. Phillips. (Seal.)

STATE OF KANSAS,
Coffey County, ss:

Be It Remembered, That on this 6th day of June, 1916, before me, the undersigned, a Notary Public in and for the County and State aforesaid, came Philip Sauder, Annie Sauder his wife, W. A. Moon, and J. W. Phillips, who are personally known to me to be the same persons who executed the within instrument of writing, and such persons duly acknowledged the execution of the same.

In Testimony Whereof, I have hereunto set my hand and affixed my notarial seal the day and year last above written. H. C. Hass, Notary Public. My commission expires July 2, 1918. (Seal.)

EXHIBIT B TO PETITION

Gridley, Kansas, June 10, 1926.

Cosden Oil & Gas Co., or Mid-Continent Oil Corporation, Mr. Harry George, Field Supt.

DEAR SIRS: I hereby wish to remind you that the time on your lease dated June 6, 1916, on my farm has expired.

The lease being for ten years or as long thereafter as oil or gas can be found in paying quantities. Now this puts it on a paying basis. Either it pays or it don't.

That is for you to say. If it pays I understand you are [fol. 9] supposed to operate and if it does not pay I understand the lease is run out and I hereby ask you to release it, except that portion which you have operated on and are producing a little oil.

Please let me know what you will do. I believe I am entitled to some action.

Yours truly, Philip Sauder.

EXHIBIT C TO PETITION

Mid-Continent Petroleum Corporation, Formerly Cosden & Company

Tulsa, Okla., June 25, 1925.

Mr. Philip Sauder, Gridley, Kansas.

DEAR SIR: Referring to yours of June 16th, please be advised that we consider we have a paying lease on your farm so will not surrender it.

Mid-Continent Petroleum Corporation, by G. O. Moody.

GOM-w.

IN DISTRICT COURT OF GREENWOOD COUNTY

NOTICE OF PETITION AND BOND FOR REMOVAL—Filed Aug. 25, 1930

To the above-named plaintiff and his attorneys of record:

You, and each of you, will take notice that on the 25th day of August, 1930, at the hour of 4:00 o'clock P. M., the above named defendant, Mid-Continent Petroleum Corporation, a corporation, will file in the above named court its petition and bond, as required by law, for the removal of the above entitled cause from the above entitled court to the District Court of the United States for the District of Kansas, Third Division, and copies of said bond and petition are hereto attached, and upon the filing of said petition and

bond said defendant will present and call to the attention of the District Court of Greenwood County, Kansas, the aforesaid petition and bond, and move said District Court of Greenwood County, Kansas, for an order of removal of said cause from the District Court of Greenwood County, [fol. 10] Kansas, to the District Court of the United States for the District of Kansas, Third Division.

J. C. Denton, J. H. Crocker, R. H. Wills, I. L. Lockewitz, Attorneys for Defendant, Mid-Continent Petroleum Corporation.

The undersigned hereby acknowledge service of the above and foregoing notice, and acknowledge receipt of a copy thereof, and of the petition and bond attached thereto, this 25th day of August, 1930.

W. L. Huggins, Ray Pierson, and Elwin Ware.

[File endorsement omitted.]

IN DISTRICT COURT OF GREENWOOD COUNTY

PETITION FOR REMOVAL.—Filed Aug. 25, 1930

Comes now the Mid-Continent Petroleum Corporation, a corporation, the defendant in the above entitled cause, and respectfully shows to the court:

That the above entitled cause is brought by the above named plaintiff, Philip Sauder, against the above named defendant, Mid-Continent Petroleum Corporation, a corporation, for the cancellation of a part of a certain oil and gas mining lease, entered into by and between the above named plaintiff and the predecessor in title of the above named defendant; that the claim of the above named plaintiff is fully stated and contained in the petition filed herein, and which said petition is hereby referred to and made a part hereof; that the portion of the lease the above named plaintiff seeks to cancel, set aside and hold for naught is of the fair cash value of the sum of Thirty-four Hundred Dollars ($3,400.00); that said cause is wholly of a civil nature at law, and that the matter and amount in dispute in said suit exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars (3,000.00).

That the controversy herein is between citizens of different states; that the plaintiff, Philip Sauder, was at the time of the commencement of this suit, and still is, a citizen and [fol. 11] resident of the State of Kansas, residing in Greenwood County, in said State, and that your petitioner, Mid-Continent Petroleum Corporation, a corporation, was at the time of the commencement of said suit, and still is, a foreign corporation, and a non-resident of the State of Kansas, and was then, and still is, a corporation duly formed, created and organized under and by virtue of the laws of the State of Delaware, having its principal office and place of business in the City of Wilmington, in said State of Delaware.

That the time within which said defendant, Mid-Continent Petroleum Corporation, is required by the laws of the State of Kansas, and the rules and practice of this court to answer or plead in this action has not expired, and that said defendant makes and files herewith a bond in the sum of Five Hundred Dollars ($500.00), with good and sufficient surety, for its entering in the United States District Court for the District of Kansas, Third Division, within thirty (30) days of the filing of this petition, a copy of the record in this suit, and for paying all costs that may be awarded by said United States District Court for the District of Kansas, Third Division, if it should hold that this suit is wrongfully or improperly removed thereto.

Wherefore, said defendant, Mid-Continent Petroleum Corporation, prays this court to proceed no further herein, except to accept this petition and to approve said bond, and make an order removing this cause to the United States District Court for the District of Kansas, Third Division, and requiring said defendant to enter and file a copy of the record herein in the United States District Court for the District of Kansas, Third Division, as required by law.

J. C. Denton, J. H. Crocker, R. H. Wills, I. L. Lockewitz, Attorneys for Defendant, Mid-Continent Petroleum Corporation.

Duly sworn to by G. O. Moody. Jurat omitted in printing.

[fol. 12] [File endorsement omitted.]

Note re Bond on Removal

Bond on removal in the sum of $500, approved by George J. Benson, Judge, with defendant as principal and New Amsterdam Casualty Company as surety, was filed in the District Court of Greenwood County, Kansas, on Aug. 25, 1930.

In District Court of Greenwood County

Order of Removal—Filed Aug. 29, 1930

This cause coming on for hearing upon the petition and bond of the defendant, Mid-Continent Petroleum Corporation, a corporation, for an order transferring this cause to the United States District Court for the District of Kansas, Third Division, and it appearing to the court that said defendant has filed its petition for such removal in due form of law, and that said defendant has filed its bond duly conditioned, with good and sufficient surety, as provided by law, and that said defendant has given the above named plaintiff due and legal notice thereof; and it appearing to this court that this is a proper cause for removal to said District Court.

Now, Therefore, Said petition and bond are hereby accepted, and it is hereby ordered and adjudged that this cause be, and it is hereby removed to the United States District Court for the District of Kansas, Third Division, and the clerk of this court is hereby directed to make up the record of said cause for transmission to said court forthwith.

Done this 29 day of August, 1930.

George J. Benson, Judge of the District Court of Greenwood County, Kansas.

[File endorsement omitted.]

[fol. 13] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 14] IN UNITED STATES DISTRICT COURT FOR THE DISTRICT OF KANSAS, THIRD DIVISION

ORDER REVIVING ACTION—Filed May 4, 1931

Now on this 4th day of May, 1931, being a regular day of the May 1931 session of said court, comes on to be heard the motion filed in the above entitled case to revive said action in the name of the Administratrix and the heirs at law of Philip Sauder, plaintiff herein, now deceased.

Plaintiffs appeared by W. L. Huggins and Ray S. Pierson, their attorneys, and the defendant appeared by Hudson & Hudson and R. H. Wills, its attorneys.

Thereupon, the matter is presented to the court and the court finds that the said Philip Sauder, plaintiff herein, died intestate on or about the 4th day of February, 1931, at his home in Greenwood County, Kansas; and the court further finds that said Philip Sauder left surviving him his widow, Annie Sauder, and his daughters, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon and Emma M. Meagher, all of whom are more than twenty-one years of age, and he also left surviving him his sons, George D. Sauder, Chester A. Sauder, Oliver J. Sauder and Harold W. Sauder, all of whom are more than twenty-one years of age. The court further finds that the said Philip Sauder left surviving him his daughter, Lorene I. Sauder, a minor, 17 years of age. The court further finds that the said Philip Sauder left surviving him Grace Annabell Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, minor grandchildren of the said Philip Sauder and children of the said Philip Sauder's son, Ralph J. Sauder, now deceased.

The court further finds that the said Annie Sauder, widow, is the duly appointed, qualified and acting administratrix of the estate of the said Philip Sauder. The court further finds that Lorene I. Sauder, minor daughter of Philip Sauder, appears herein by her mother and next friend, the said Annie Sauder. The court further finds that the said minor grand-children above named appear herein by their mother and next friend, Mrs. Mina Sauder. The court further finds that the said minor heirs of the said Philip Sauder, deceased, above named, have no legal guardian.

Thereupon, upon due consideration, the court finds that this action should be revived in the names of said Admin-
[fol. 15] istratrix and said heirs of the said Philip Sauder, deceased.

It is therefore, by the court, ordered that this cause be and it is hereby revived in the names of the said heirs and said Administratrix, and the title of this action hereafter shall be:

Annie Sauder, Administratrix of the Estate of Philip Sauder, Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, by Annie Sauder, her mother and next friend; Grace Annabell Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, minors, by Mina Sauder, their mother and next friend, Plaintiffs, vs. Mid-Continent Petroleum Corporation, a corporation, Defendant.

It is further ordered that said plaintiffs be and they are given and allowed ten days from this date in which to file an amended petition herein, to all and each of which said ruling and order defendant duly excepted. Defendant is granted ten days thereafter in which to plead to such amended petition.

Richard J. Hopkins, Judge of the United States District Court for the District of Kansas, Third Division.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

No. 337-N

ANNIE SAUDER, Administratrix of the Estate of Philip Sauder, Deceased; Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, by Annie Sauder, Her Mother and Next Friend; Grace Annabell

Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, Minors, by Mina Sauder, Their Mother and Next Friend, Plaintiffs,

vs.

Mid-Continent Petroleum Corporation, a Corporation, Defendant

Amended Petition—Filed May 4, 1931

Come now the plaintiffs, above named, and by permission and order of the court file this, their Amended Petition, in the above entitled cause, and for their cause of [fol. 16] action against the defendant above named, allege and show the court:

That Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder and Lorene I. Sauder, are bona fide residents of the State of Kansas and their post office address is Gridley, Kansas; that the said Lillian F. Pinon is a bona fide resident of the State of Kansas, and her post office address is Madison, Kansas; that the said Emma M. Meagher is a bona fide resident of the State of Indiana and her post office address is New Haven, Indiana; that the said Grace Annabell Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, minors, are residents of the State of Kansas and their post office address is Burlington, and the said Mina Sauder is a resident of Kansas and her post office address is Burlington, Kansas.

Plaintiffs further allege and show the court that they are the heirs at law and the said Annie Sauder is also the Administratrix of the estate of Philip Sauder; that the said Philip Sauder died intestate at his home in Greenwood County, Kansas, on the 4th day of February, 1931; that at the time of the death of the said Philip Sauder, he was, and for many years prior thereto, had been, the owner of the following described real estate situated in the County of Greenwood and State of Kansas, to-wit:

The East Half and the Southeast Quarter of the Southwest Quarter of Section 16, Township 23, Range 13, containing 360 acres more or less.

Plaintiffs further allege that upon the death of said Philip Sauder as aforesaid, these plaintiffs, under and by

virtue of the laws of descents and distributions of the State of Kansas, immediately became, and they are now, the owners of said real estate in fee simple.

Plaintiffs allege that heretofore and upon the 6th day of June, A. D. 1916, the said Philip Sauder, deceased, made and executed and delivered to W. A. Moon and J. W. Phillips his certain oil and gas lease, in writing, of that date, by the terms of which he leased said land for gas and oil. A copy of said lease is attached hereto, marked Exhibit A, and is hereby made a part of his petition as fully as though written in at this place in full.

[fol. 17] Plaintiffs further allege and show the court that thereafter and upon August 9, 1917, said Moon and Phillips duly assigned said lease to Atlantic Petroleum Corporation, and said assignment is of record in the office of the Register of Deeds of Greenwood County, Kansas, in Book 2 of Assignments at Page 241. That thereafter and upon February 24, 1925, said Atlantic Petroleum Corporation duly assigned said lease to Cosdon & Company and said assignment is of record in the office of said Register of Deeds in Book CC of Miscellaneous records at page 325. That thereafter, but plaintiffs cannot give the exact date, said Cosden & Company became the Mid-Continent Petroleum Corporation, and said Mid-Continent Petroleum Corporation became and is the owner of said lease.

The said Mid-Continent Petroleum Corporation, defendant above named, is a Delaware corporation with its post office and place of business at Tulsa, Oklahoma, and is authorized to do business in the State of Kansas as such corporation.

Plaintiffs further allege and show the court that thereafter and on or about the 1st day of November, 1921, the said defendant, Mid-Continent Petroleum Corporation, completed a well in accordance with the terms of said oil and gas lease Exhibit A, upon the Southeast Quarter of the Southwest Quarter of said Section 16, and that oil and gas were found therein in paying quantities. Said plaintiffs further allege and show the court that thereafter and on or about the 1st day of January, 1922, said defendant, Mid-Continent Petroleum Corporation, completed another well upon said Southeast Quarter of the Southwest Quarter of said Section 16, and found therein oil in paying quantities; that aside from said two wells above described,

during all the years intervening since the date of said lease, no effort has been made and no act performed by said defendant, Mid-Continent Petroleum Corporation, or any other holder or owner of said lease, toward the development of said real estate described above for oil and gas. No well has been drilled, no locations made, no effort whatever has been put forth by said defendant, Mid-Continent Petroleum Corporation, to explore for oil and gas or to develop said land for oil and gas; that on or about the 1st day of January, 1922, for the purpose of pumping the two wells above herein described, the said defendant located [fol. 18] and erected upon said Southeast Quarter of the Southwest Quarter of Section 16, a power plant; that until the year 1927, the exact time the plaintiffs are unable to state, said two wells were pumped by power furnished by said power plant located on said Southeast Quarter of the Southwest Quarter of Section 16, but that thereafter, and about the month of September, 1927, the said defendant, Mid-Continent Petroleum Corporation, removed said power plant and procured power for the pumping of said two wells from an adjacent leasehold operated by said defendant, and is still so procuring power for that purpose.

Plaintiffs further allege that on or about the 11th day of December, 1924, the exact date the plaintiffs cannot state, the said Philip Sauder demanded of the then owners of said lease and predecessors of Mid-Continent Petroleum Corporation, that they proceed with the development and exploration of said real estate above described for gas and oil; that said demand was upon one George, who at the time was District Supt. for the Cosden and Company and The Atlantic Petroleum Corporation, predecessors of said Mid-Continent Petroleum Corporation, in charge of this and other property in Greenwood County, and Woodson County, Kansas. Said Philip Sauder made similar demands at various times from the date of said lease until 1928, on various employees and agent of said holders of said lease, but said plaintiffs are unable to state names or dates.

Plaintiffs further allege and show the court that on the 6th day of June, 1926, the said Philip Sauder wrote a letter to the said defendant, Mid-Continent Petroleum Corporation, calling attention to the fact that no work had been

done toward the exploration or development of any of the property herein described, except said Southeast Quarter of the Southwest Quarter of said Section 16, and demanding that development proceed, and if said Mid-Continent Petroleum Corporation did not intend to develop said land that the said lease should be cancelled by said Mid-Continent Petroleum Corporation. A copy of said letter is hereto attached, marked Exhibit B and made a part of this Amended Petition. That shortly thereafter the said Philip Sauder received a letter from said Mid-Continent Petroleum Corporation, in which the said Mid-Continent Petroleum Corporation stated that it considered said lease a valuable one and that it would not cancel the same. A copy [fol. 19] of said letter is hereto attached marked Exhibit C, and made a part of this Amended Petition. Plaintiffs further allege and show the court that no effort has since that time been made and no act performed toward the development of said leased premises or any part thereof.

Plaintiffs further allege and show the court that there is oil development upon land adjacent to the land in question as follows: That on the half section of land immediately east of said half section owned by plaintiffs, there are now 25 producing oil wells, producing oil in good paying quantities; that upon the quarter section of land immediately north of the Northeast Quarter of said Section 16, there is a producing oil well; that upon the North Half of the Southwest Quarter of said Section 16, lying immediately west of plaintiffs' land, there are 3 oil wells, producing oil in paying quantities, and one dry hole has been drilled upon said 80 acres of land; that upon a 40 acre tract of land, being the Southwest Quarter of the Southwest Quarter of said Section 16, there are three producing oil wells and no dry wells; that upon the North Half of Section 21, lying immediately south of the said Section 16, there are 15 producing oil wells producing oil in paying quantities and only one dry hole; that upon the Northwest Quarter of Section 22, lying immediately south and east of said Section 16 and cornering with the plaintiffs' land, there are 12 producing oil wells, producing oil in paying quantities and no dry hole has been drilled upon said property. That from the oil wells upon adjacent land, although none are closer than four hundred feet from plaintiffs' line, several are close enough, that plaintiffs are informed and verily

believe, and therefore allege, that there is grave danger that oil deposits, if any, under the land of these plaintiffs, will be drawn off or depleted by the pumping of oil upon adjacent land; that said oil production upon adjacent land has been going on for a number of years and that no new wells have been drilled upon said adjacent land since the year 1922.

Plaintiffs further allege and show the court that under the terms of said lease it was the duty of the holders thereof and especially of the defendant, Mid-Continent Petroleum Corporation, to fully explore and develop said lands for oil and gas, and plaintiffs allege that during the [fol. 20] past years and ever since June 6, 1916, the said defendant, Mid-Continent Petroleum Corporation, and all of the parties to whom said lease may have been assigned have wholly failed, refused and neglected to develop said land for oil and gas with the single exception of the two wells hereinbefore mentioned on the Southeast Quarter of the Southwest Quarter of said Section 16 and adjacent to the Southwest corner of said Half Section herein described belonging to plaintiffs; that no effort whatever has been made to explore the east half of said Section 16; that the said defendant, Mid-Continent Petroleum Corporation, although repeatedly requested and demanded so to do, as hereinbefore stated, has wholly refused and failed to further develop said land for gas and oil.

Plaintiffs further allege that since the year 1922, at least, the development of oil upon land adjacent to the land described herein belonging to plaintiffs has made it practically certain that oil could have been discovered in paying quantities by the drilling of wells upon said East Half of said Section 16, but that notwithstanding said fact, the said defendant, Mid-Continent Petroleum Corporation, has refused to develop said land and has held the same for speculative purposes and that by reason of such refusal said defendant, Mid-Continent Petroleum Corporation, in equity and good conscience, has forfeited its right to further hold said lease and should be by this court, adjudged and decreed to be wholly in default of its obligations under the terms of said lease, and said lease should be by the court cancelled, set aside and held for naught as to all of said land described herein, with the possible exception of land immediately adjacent to the two wells heretofore de-

scribed lying and situate in the South part of the Southeast Quarter of the Southwest Quarter of said Section 16.

Plaintiffs further allege that unless said lease be cancelled by this court, said defendant, Mid-Continent Petroleum Corporation, will continue to hold said lease for speculative purposes and thereby plaintiffs will be deprived of the very objects, purposes, and things which were the consideration for the execution of said oil and gas lease in the first instance.

Wherefore, The premises considered, plaintiffs pray for a judgment and decree of this honorable court, cancelling said lease and that said lease be cancelled, set aside and [fol. 21] held for naught as to all of said lands, except such portion of said Southeast Quarter of the Southwest Quarter of Section 16, immediately adjacent to said two wells described in the petition herein, as the court may designate and plaintiffs pray that they have such other, further and additional relief as they may be entitled to receive in equity and good conscience, including their costs herein expended.

W. L. Huggins, Ray S. Pierson, Attorneys for Plaintiffs.

Exhibit A omitted here, being identical with Exhibit A on page 6 of this record.

Exhibit B omitted here, being identical with Exhibit B on page 8 of this record.

Exhibit C omitted here, being identical with Exhibit C on page 9 of this record.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

ANSWER—Filed Nov. 30, 1931

Comes now the defendant, Mid-Continent Petroleum Corporation, a corporation, and for its answer to the amended petition of the above named plaintiffs, and each of them, states, alleges and denies:

1. That said defendant alleges that the facts stated or attempted to be stated in the amended petition of the above

named plaintiffs are insufficient to constitute a valid cause of action in favor of said plaintiffs and against said defendant.

2. That said defendant admits that it is a corporation, duly organized and existing under and by virtue of the laws of the State of Delaware, and is authorized to transact business in the State of Kansas.

3. That said defendant admits that Philip Sauder died intestate in Greenwood County, Kansas, on the 4th day of February, 1931; admits that at the time of his death he was, subject to the oil and gas lease and leasehold estate hereinafter described, the owner in fee of the real estate and premises involved herein; admits that Annie Sauder [fol. 22] is the administratrix of the estate of the said Philip Sauder, deceased; and admits that the above named plaintiffs, Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, Grace Annabell Sauder, a minor, Everett Alvin Sauder, a minor, Ray Arthur Sauder, a minor, and Irene Evelyn Sauder, a minor, are the sole and only heirs at law of Philip Sauder, deceased.

4. That said defendant admits that the aforesaid Philip Sauder, together with Annie Sauder, his wife, on June 6, 1916, made, executed and delivered to W. A. Moon and J. W. Phillips an oil and gas mining lease covering the real estate and premises involved herein, and further admits that said oil and gas mining lease was by mesne assignments sold and transferred to said defendant, and that said defendant is now the owner and holder thereof.

5. That said defendant admits that in accordance with the terms and provisions of the above mentioned and described oil and gas mining lease said defendant, or its predecessors in title, drilled and completed two producing oil wells on a portion of the real estate involved herein, said oil wells being located on the Southeast Quarter ($SE\frac{1}{4}$) of the Southwest Quarter ($SW\frac{1}{4}$) of Section Sixteen (16), Township Twenty-three (23), Range Thirteen (13) in Greenwood County, Kansas; admits that oil in paying quantities was discovered in each of said wells; and admits

that it has drilled no other or additional wells on the real estate and premises involved herein.

6. That with reference to that paragraph of plaintiffs' said amended petition beginning with the words: "Plaintiffs further allege and show to the court that there is oil development upon lands adjacent to the land in question," etc., and ending with the words: "adjacent land since the year 1922," said defendant states and alleges that it is without sufficient knowledge or information to admit or deny the allegations of said paragraph of said amended petition, save and except as is herein expressly and specifically admitted or denied.

7. That said defendant admits that there have been and are now certain producing oil wells in the immediate [fol. 23] vicinity of the real estate and premises involved herein, but denies that any of said wells are within 400 feet of the boundary lines of the real estate and premises involved herein, except certain wells offsetting the two above described wells on the real estate and premises involved herein, and as to such wells which are within 400 feet of the boundary lines of the real estate and premises involved herein, and each of them, said defendant states and alleges that it has properly offset the same by drilling, completing and operating the two aforesaid oil wells which are located on the real estate and premises involved herein. That said defendant further denies that any of the oil wells in the immediate vicinity of the real estate and premises involved herein have drained or are draining, or are likely to drain, any of the oil or gas underneath the surface of the real estate and premises involved herein, and alleges that said defendant and its predecessors in title have in all respects complied with all of the express and implied terms, covenants and provisions of the aforesaid oil and gas mining lease, and that said lease is now, and has at all times been, a good, valid and subsisting oil and gas mining lease on the real estate and premises involved herein, and each and every part thereof, and that said defendant is entitled to possession of said real estate and premises, and each and every part thereof, for the purposes of said lease.

8. That said defendant further alleges and states that the oil wells located upon the real estate and premises involved herein, and each and all of the oil wells that have

been drilled in the immediate vicinity of said real estate and premises, are small producers, and that most, if not all, of such oil wells have not produced sufficient, and probably will never produce sufficient oil and gas to pay for the cost of drilling, equipping and operating the same.

9. That said defendant further alleges and states that it has properly offset all wells upon the premises adjoining the real estate and premises involved herein which it was required to offset under the express or implied terms, covenants and provisions of the above mentioned and described oil and gas mining lease, and that it has drilled as many oil wells upon said real estate and premises as under the circumstances could be reasonably expected of operators of ordinary prudence, taking into consideration the cost of drilling, cost of material, operating expenses and [fol. 24] market conditions, and having regard to the interests of both the lessor and lessee.

10. That said defendant further states and alleges that it is without information or knowledge as to whether or not the aforesaid Philip Sauder on December 11, 1924, or any other time or times, made any demand or demands upon its predecessors in title, or any of them, to further develop the real estate and premises involved herein for oil or gas, or to offset any well or wells upon adjoining premises, as is alleged in plaintiffs' said amended petition, and therefore is not able to admit or deny the same.

11. That said defendant denies that the aforesaid Philip Sauder, or the above named plaintiffs, or any of them, has or have ever made any demand or demands upon it, or any of its agents, servants or employees, to further develop the real estate and premises involved herein for oil or gas, or to offset any well or wells upon adjoining premises, as is alleged in plaintiff's amended petition, and said defendant denies that on or about the 11th day of December, 1924, one George was its agent, servant or employee.

12. That said defendant admits that the aforesaid Philip Sauder wrote said defendant under date of June 16th, 1926, the letter, a copy of which is attached to plaintiff's amended petition, marked Exhibit B and made a part thereof, and that under date of June 25th, 1926, said defendant replied to said letter and that a copy of said reply

is attached to plaintiffs' amended petition, marked Exhibit C and made a part thereof.

13. That said defendant denies that it has forfeited any of its rights under the above mentioned and described oil and gas mining lease, or that it is holding the same for speculative purposes, but alleges and states that it and its predecessors in title have complied with each and all of the express and implied terms, conditions and covenants of said lease; that the two above mentioned and described wells upon the real estate and premises involved herein are now producing, and have at all times since their completion produced oil in paying quantities; and that said lease is now, and has at all times been, in full force and effect, and that said defendant is the absolute owner and holder thereof, and is entitled to the possession of the real [fol. 25] estate and premises covered by said lease, and each and every part thereof, for the purposes of said lease.

Wherefore, Said defendant prays that said plaintiffs take nothing by their suit, and that the same be dismissed, and that the defendant have judgment for its costs herein, and such other and further relief as may be just and equitable.

Hudson & Hudson, J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewitz, J. P. Greve, Attorneys for Defendant.

[File endorsement omitted.]

REPLY—Filed Dec. 10, 1931

Come now the plaintiffs above named and each of them and for their reply to the answer of the defendant filed herein, say:

Plaintiffs deny each and every allegation, matter and thing in said answer contained which is in any way contradictory to or inconsistent with the averments contained in the amended petition of said plaintiffs filed herein.

Wherefore, Plaintiffs pray as in their said Amended Petition.

W. L. Huggins, Ray S. Pierson, Attorneys for Plaintiffs.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

DEFENDANT'S REQUEST FOR FINDINGS OF FACT AND CONCLUSIONS OF LAW—Filed June 16, 1932

Comes now the above named defendant, Mid-Continent Petroleum Corporation, and respectfully requests the court to make the following findings of fact and conclusions of law, to-wit:

Findings of Fact

1. That on the 6th day of June, 1916, Philip Sauder and [fol. 26] Annie Sauder, his wife, being then and there the owners in fee simple of the

East Half (E½) and the Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of Section Sixteen (16), Township Twenty-three (23), Range Thirteen (13), containing 260 acres, more or less,

for a good and valuable consideration, made, executed, acknowledged and delivered to W. A. Moon and J. W. Phillips an oil and gas lease upon said real estate and premises; that on the 4th day of November, 1916, said lease was filed for record in the office of the Register of Deeds of Greenwood County, Kansas, and recorded in Book 3 of the Oil and Gas Records at page 440; and that a true and correct copy of said lease is attached to the plaintiffs' amended petition, marked Exhibit A and made a part thereof.

2. That at and prior to the date of the commencement of this action the above named defendant, by mesne assignments, was the absolute owner and holder of said oil and gas mining lease and was in possession of the above described real estate and premises under and by virtue of said lease, and is now and has been at all times since the commencement of this action in such possession.

3. That on the 4th day of February, 1931, the aforesaid Philip Sauder, who was the original plaintiff herein, died intestate in Greenwood County, Kansas, and that at the time of his death he was, subject to the oil and gas leasehold estate herein described, the owner in fee simple of the real estate and premises involved herein; that the above named plaintiff, Annie Sauder, is the administratrix of the estate of the said Philip Sauder, deceased; and that the

above named plaintiffs, Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, Grace Annabell Sauder, a minor, Everett Alvin Sauder, a minor, Ray Arthur Sauder, a minor, and Irene Evelyn Sauder, a minor, are the sole and only heirs of the said Philip Sauder, deceased.

4. That within ten (10) years from the date of the execution, acknowledgment and delivery of the aforesaid oil and gas mining lease the defendant, Mid-Continent Petro-[fol. 27] leum Corporation, or its predecessors in title, drilled and completed two oil wells upon the above described real estate and premises, and that such wells were drilled under and by virtue and pursuant to the terms, conditions and provisions of said lease; that oil was discovered in each of said wells in paying quantities; and that at all times subsequent to the drilling and completion of said two wells the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, have produced oil in paying quantities from each of said wells under and by virtue of the aforesaid lease, and said defendant, Mid-Continent Petroleum Corporation, is now producing oil in paying quantities from each of said wells under and by virtue of said lease.

5. That there have been and are now certain producing oil wells in the immediate vicinity of the real estate and premises involved herein, but none of said wells are within 400 feet of the boundary lines of the real estate and premises involved herein, except certain wells offsetting the two above described wells on the real estate and premises involved herein; that as to such wells as are within 400 feet of the boundary lines of the real estate and premises involved herein, and each of them, said defendant has properly offset the same by drilling and completing and operating the two aforesaid oil wells which are located upon the real estate and premises involved herein; and that none of the oil wells in the immediate vicinity of the real estate and premises involved herein drain or are draining or are likely to drain any oil and gas from underneath the surface of the real estate and premises involved herein.

6. That none of the wells upon any of the real estate and premises adjoining the real estate and premises involved herein is an offset well save and except the certain wells which offset the two above described wells on the real estate and premises involved herein.

7. That the above named defendant and those from and under whom it claims have diligently operated and developed the above described real estate and premises for oil and gas purposes and have fully and completely performed all of their express and implied obligations under and by virtue of the above described oil and gas mining lease.

8. That the defendant, Mid-Continent Petroleum Cor- [fol. 28] poration and its predecessors in title have drilled as many wells upon the real estate and premises involved herein as could be reasonably expected of an oil and gas operator of ordinary prudence and that no oil or gas operator of ordinary prudence would have drilled any additional well upon said real estate and premises.

9. That the above named defendant, nor any of those from and under whom it claims, has abandoned any part of the above described oil and gas lease, or any part of the premises covered thereby.

10. That prior to the commencement of this action neither the above named Philip Sauder nor the above named plaintiffs, or any of them, made any demand or demands upon the defendant, Mid-Continent Petroleum Corporation, or any of its predecessors in title, to drill any well or wells upon the real estate and premises, involved herein in addition to the two wells drillled thereon, or to further develop said real estate and premises for oil or gas.

11. That the court finds each and all of the other issues of fact involved herein in favor of the above named defendant and against the above named plaintiffs.

Conclusions of Law

1. That the defendant, Mid-Continent Petroleum Corporation, is the absolute owner and holder of the above mentioned and described oil and gas mining lease, and that said oil and gas mining lease is a good, valid and subsisting oil and gas mining lease and is in full force and effect as to each and every part of the 360 acres of land covered

thereby, and that said defendant is entitled to the possession of said 360 acres and each and every part thereof under and by virtue of said lease and for the purposes thereof.

2. That the plaintiffs are not entitled to the cancellation of the above mentioned and described oil and gas mining lease, or any part thereof, or insofar as the same covers any portion of the 360 acres of land above described.

3. That the evidence herein is wholly insufficient to entitle the plaintiffs to any judgment whatsoever against the defendant, and that the defendant is entitled to judgment herein.

4. That the court finds each and all the other issues of law [fol. 29] involved herein in favor of the defendant and against the plaintiffs.

Hudson & Hudson, J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewitz, J. P. Greve, Attorneys for Defendant.

[File endorsement omitted.]

In United States District Court

Plaintiffs' Request for Findings of Fact and Conclusions of Law—Filed June 2, 1932

Come now the above named plaintiffs and respectfully request the court to make the following findings of fact and conclusions of law, to-wit:

Findings of Fact

1. That on the 6th day of June, 1916, Philip Sauder and Annie Sauder, his wife, being then and there the owners in fee simple of the

East Half (E½) and the Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of Section Sixteen (16), Township Twenty-three (23), Range Thirteen (13) containing 360 acres, more or less, Greenwood County, Kansas,

for a good and valuable consideration, made, executed, acknowledged and delivered to W. A. Moon and J. W. Phillips an oil and gas lease upon said real estate and premises; that

on the 4th day of November, 1916, said lease was filed for record in the office of the Register of Deeds of Greenwood County, Kansas, and recorded in Book 3 of the Oil and Gas Records at page 440; and that a true and correct copy of said lease is attached to the plaintiffs' amended petition, marked Exhibit A and made a part thereof.

2. That at and prior to the date of the commencement of this action the above named defendant, by mesne assignments, was the absolute owner and holder of said oil and gas mining lease.

3. That on the 4th day of February, 1931, the aforesaid [fol. 30] Philip Sauder, who was the original plaintiff herein, died intestate in Greenwood County, Kansas, and that at the time of his death he was, subject to the oil and gas leasehold estate herein described, the owner in fee simple of the real estate and premises involved herein; that the above named plaintiff, Annie Sauder, is the administratrix of the estate of the said Philip Sauder, deceased; and that the above named plaintiffs, Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian E. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, Grace Annabell Sauder, a minor, Everett Alvin Sauder, a minor, Ray Arthur Sauder, a minor, and Irene Evelyn Sauder, a minor, are the sole and only heirs of the said Philip Sauder, deceased.

4. That within ten (10) years from the date of the execution, acknowledgment and delivery of the aforesaid oil and gas mining lease the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, drilled and completed two oil wells upon the above described real estate and premises, and that such wells were drilled as offsets to wells drilled and producing oil on an adjacent leasehold. Said two oil wells were drilled in the southwest quarter of the southeast quarter of the southwest quarter of said section 16 and at the extreme southwest corner of said leasehold; that oil was discovered in each of said wells in paying quantities; and that at all times subsequent to the drilling and completion of said two wells the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, have produced oil in paying quantities from each of said wells; and said defendant, Mid-Continent Petroleum

Corporation, is now producing oil in small but paying quantities from each of said wells.

5. That there has been oil development on lands adjacent to the real estate herein described, and there are now and since about 1921 and 1922 have been many producing oil wells to the east and south bordering upon the real estate herein described, and to the southwest and the northeast on lands cornering with the lands herein described; that on the half section of land immediately east of the half section described in said lease there are approximately 25 producing oil wells; that upon the half section of land lying immediately south of said section there are approximately [fol. 31] 15 producing oil wells; that upon the quarter section cornering with the half section described in the lease to the south and east thereof there are approximately 12 producing oil wells; that west from the two offset wells drilled by the defendant upon the land described in said lease and upon the southwest quarter of said Section 16 there are three producing oil wells; that on the half section cornering with the half section described in the lease to the northeast there is considerable oil production, but the record does not show the exact amount thereof; that directly north of said Section 16, but at considerable distance, there is oil production, but the evidence does not show the extent thereof.

6. None of the oil wells referred to in Finding No. 5 above are within 400 feet of the property line of the land described in the lease with the exception of wells to the south which have been offset by the two wells drilled upon this property. The defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from the plaintiffs' land. These witnesses, however, admitted that they might be mistaken as there was no absolute way of determining the question of drainage except by drilling tests. This evidence as to drainage is not wholly convincing to the court. There is, in the opinion of the court, some probability that damage is being done to this leasehold by drainage upon the adjoining properties.

7. The defendant owns and is operating an oil lease on the south half of the half section lying immediately east of

Section 16 and the lease on the land cornering upon the south half of Section 16 on the southeast, and the lease on the land on the south of said southeast quarter of the southwest quarter of said Section 16 hereinbefore described.

8. On the basis of the oil development and oil production upon adjacent lands, as shown by the evidence herein, plaintiffs contend that a well-defined "trend" of oil producing sand and lime runs in a southwesterly northeasterly direction under and across the land described in said lease. Expert evidence introduced by the defendant tended to prove that no such "trend" exists under and across the land described in said lease, but that on the contrary the oil sand is not to be found under said land and the depth of the [fol. 32] lime under said land, as estimated by Geologists, is so great that the probabilities are no oil would be found in it. On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of section 16 but no dry well has been drilled on any of the property covered by this lease.

9. On the 16th day of June, 1926, Philip Sauder, then the owner of the land described in said lease, wrote a letter to the defendant, in substance, calling the attention of the defendant to the expiration of the ten year term of said lease, and that no wells had been drilled except the two wells heretofore mentioned and demanding that the defendant proceed to explore and develop said land by the drilling of additional wells, or in the alternative that the defendant "release" its claim to all of said land except that part upon which the two wells had been drilled and were producing oil. On June 25, 1926, the said defendant replied to said letter from Philip Sauder, in which letter it stated, in substance, that it considered said lease a valuable one and would not surrender the same.

10. No effort has been made by the defendant since said letters toward exploration or development by the drilling of wells or otherwise and the evidence in this case shows that the defendant and its officers and employes have no present

intention of further exploring or developing said lease and no intention ever to further develop said lease unless and until further developments in the immediate vicinity thereof might convince said defendant and its officers and agents that it would pay the defendant to further explore or develop said lease.

11. The court finds each and all of the other issues of fact involved herein in favor of the plaintiffs and against the defendant.

Conclusions of Law

1. Under the facts and circumstances in this case, as shown by the evidence and the record, the plaintiffs have no adequate remedy at law.

[fol. 33] 2. The defendant and its predecessors in title have not in good faith and with reasonable diligence explored and developed the lands described in this lease in accordance with the express and implied covenants of said lease.

3. It would be inequitable and unjust to permit the defendant to hold, keep and retain the leasehold property involved herein without further exploration or development, as said defendant proposes to do, as shown in the pleadings and evidence herein.

4. The plaintiffs, under the evidence, are entitled to a judgment of this court canceling said lease as to all the land described therein except the southwest quarter of the southeast quarter of the southwest quarter of said section 16 upon which the two offset wells heretofore mentioned were drilled and developed by defendant or its predecessors in title.

5. The defendant is entitled to hold and enjoy its leasehold rights upon said ten acres of land described in Conclusion of Law No. 4 herein so long as it produces gas or oil therefrom in paying quantities.

6. The court finds each and all the other issues of law involved herein in favor of the plaintiffs and against the defendant.

Ray S. Pierson, W. L. Huggins, Attorneys for Plaintiffs.

[File endorsement omitted.]

In United States District Court

Memorandum Decision—Filed July 25, 1932

Hopkins, District Judge:

The action is one in Equity to set aside an oil and gas lease because of failure on part of lessee to explore and develop. I find the facts to be substantially as follows:

On June 6, 1916, Philip Sauder and Annie Sauder, his wife, being then and there owners in fee simple of the 260 acres of land in Greenwood County, for a good and valuable consideration, executed and delivered to W. A. Moon and J. W. Phillips an oil and gas lease upon said premises, which lease was duly recorded in the office of the Register [fol. 34] of Deeds of Greenwood County; that a copy thereof was made a part of plaintiffs' amended petition.

That at and prior to the date of the commencement of this action, the above named defendant, by mesne assignments, was the absolute owner and holder of said oil and gas mining lease.

That on the 4th day of February, 1931, the aforesaid Philip Sauder, who was the original plaintiff herein, died intestate in Greenwood County, Kansas, and that at the time of his death he was, subject to the oil and gas leasehold estate herein described, the owner in fee simple of the real estate and premises involved herein; that the above named plaintiff, Annie Sauder, is the administratrix of the estate of the said Philip Sauder, deceased; and that the above named plaintiffs, Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, Grace Annabell Sauder, a minor, Everett Alvin Sauder, a minor, Ray Arthur Sauder, a minor, and Irene Evelyn Sauder, a minor, are the sole and only heirs of the said Philip Sauder, deceased:

That within ten (10) years from the date of the execution, acknowledgment and delivery of the aforesaid oil and gas mining lease the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, drilled and completed two oil wells upon the above described real estate and premises, and that such wells were drilled as off-sets

to wells drilled and producing oil on an adjacent leasehold. Said two oil wells were drilled in the southwest quarter of the southeast quarter of the southwest quarter of said section Sixteen (16) and at the extreme southwest corner of said leasehold; that oil was discovered in each of said wells in paying quantities; and that at all times subsequent to the drilling and completion of said two wells the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, have produced oil in paying quantities from each of said wells; and said defendant, Mid-Continent Petroleum Corporation, is now producing oil in small but paying quantities from each of said wells.

That there has been oil development on land adjacent to the real estate herein described, and there are now and since [fol. 35] about 1921 and 1922 have been many producing oil wells to the east and south bordering upon the real estate herein described, and to the southwest and the northeast on lands cornering with the lands herein described; that on the half section of land immediately east of the half section described in said lease there are approximately twenty-five producing oil wells; that upon the half section of land lying immediately south of said section there are approximately fifteen producing oil wells; that upon the quarter section cornering with the half section described in the lease to the south and east thereof there are approximately twelve producing oil wells; that west from the two offset wells drilled by the defendant upon the land described in said lease and upon the southwest quarter of said Section 16 there are three producing oil wells; that on the half section cornering with the half section described in the lease to the northeast there is considerable oil production, but the record does not show the exact amount thereof; that directly north of said Section 16, but at considerable distance, there is oil production, but the evidence does not show the extent thereof.

None of the oil wells referred to in the above finding are within four hundred feet of the property line of the land described in the lease with the exception of wells to the south which have been offset by the two wells drilled upon this property. The defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from the plain-

tiff's land. These witnesses, however, admitted that they might be mistaken as there was no absolute way of determining the question of drainage except by drilling tests. This evidence as to drainage is not wholly convincing to the court. There is, in the opinion of the court, some probability that damage is being done to this leasehold by drainage upon the adjoining properties.

The defendant owns and is operating an oil lease on the south half of the half section lying immediately east of Section Sixteen (16) and the lease on the land cornering upon the south half of Section Sixteen (16) on the southeast, and the lease on the land on the south of said southeast quarter of the southwest quarter of said Section Sixteen (16) hereinbefore described.

[fol. 36] On the basis of the oil development and oil production upon adjacent lands, as shown by the evidence herein, plaintiffs contend that a well-defined "trend" of oil producing sand and lime runs in a southwesterly-northeasterly direction under and across the land described in said lease. Expert evidence introduced by the defendant tended to prove that no such "trend" exists under and across the land described in said lease, but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said land, as estimated by geologists, is so great that the probabilities are no oil would be found in it. On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of Section Sixteen (16) but no dry well has been drilled on any of the property covered by said lease.

On the 16th day of June, 1926, Philip Sauder, then the owner of the land described in said lease, wrote a letter to the defendant, in substance, calling the attention of the defendant to the expiration of the ten year term of said lease, and that no wells had been drilled except the two wells heretofore mentioned and demanding that the defendant proceed to explore and develop said land by the drilling of additional wells, or in the alternative that the defendant

"release" its claim to all of said land except that part upon which the two wells had been drilled and were producing oil. On June 25, 1926, the said defendant replied to said letter from Philip Sauder, in which letter it stated, in substance, that it considered said lease a valuable one and would not surrender the same. No effort has been made by the defendant since said letters toward exploration or development by the drilling of wells or otherwise and the evidence in this case shows that the defendant and its officers and employes have no present intention of further exploring or developing said lease and no intention ever to further develop said lease unless and until further developments in the immediate vicinity thereof might convince said defendant and its officers and agents that it would pay the defendant to further explore or develop said lease.

[fol. 37] The court finds each and all of the other issues of fact involved herein in favor of the plaintiffs and against the defendant.

The defendant contends that the decision in this case is controlled by Denker vs. Mid-Continent Petroleum Corporation, 56 Federal (2nd) 725, relying on the theory that the facts in the instant case are so similar to those in the Denker case that the court is bound by its decision. I do not think so. The acreage in the instant case is two and one-fourth times the acreage in the Denker case. The two quarter sections in the instant case have been wholly unexplored and undeveloped. No wells whatever have been drilled on the lease here in controversy for exploration purposes. Two wells only have been put down, because two offset wells were compelled by the drilling of wells on an adjacent tract. In the instant case the defendant holds a lease on the three hundred and sixty acres more than sixteen years old which by its terms expired more than six years ago unless it has been continued in force by the two offset wells. The evidence offered by the defendants indicates no intention to further develop. That is to say, evidence of the defendant tends to show that the land covered by the lease in the instant case is worthless for oil drilling purposes.

In contrast the Denker case involved a lease on one hundred and sixty acres of land. Eight wells were drilled thereon, five of them for exploration purposes, three for offset. It is perfectly apparent that the court in the Den-

ker case believed and found that the defendant company had in good faith explored and developed the leasehold property. I am forced to the conclusion that such has not been true of the defendant in the instant case. In the Denker case it is shown that the developing company expended something over $425,000.00 in development and operation of that quarter section, that the land owner without expenditure on his part had collected as royalty therefrom more than $56,000.00. In the instant case the landlord's receipts for more than sixteen years on the three hundred sixty acres has been less than $10,000.00. If the lease is worthless as contended by defendant it is neither equitable nor just to permit the defendant to continue to hold the lease except upon the ten acres where the two offset wells are located.

[fol. 38] I think the question of the defendant's diligence in exploring the premises is of paramount importance. In Brewster vs. Lanyon Zinc Co., 140 Federal, 801, it is said, "Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee is what is required."

* * * * * * *

"Because forfeitures are usually harsh and oppressive, and because they can ordinarily be enforced at law, courts of equity generally refuse to aid in their enforcement; but the rule is not absolute or inflexible. Its influence and operation do not extend beyond the reasons which underlie it, and in cases, otherwise cognizable in equity there is no insuperable objection to the enforcement of a forfeiture in a court of equity when that is more consonant with the principles or right, justice, and morality, than to withhold equitable relief.

* * * * * * *

See also Huggins, et al., Daley 99 Federal, 606, Logan Natural Gas Co. vs. Great Southern Gas and Oil Co., 126 Federal, 623. In Webbs vs. Croft, 120 Kansas, 657, it is said, "Defendants contend that as they had kept the lease alive by drilling one well during the lease period and had paid the accrued rentals and royalties, the court was not warranted in requiring further development, and that it therefore had read into the contract conditions not stipulated by the parties and had placed burdens on the defendants not contemplated by the contract. Leases of this kind contemplate exploration and development and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that [fol. 39] there shall be reasonable development and such operation as will protect the interests of both the lessor and lessee."

In McCarney vs. Freel, et al., 121 Kansas, p. 189, it is said, "A lessee may not hold an entire quarter section of land with a single producing well after expiration of term, any more than he may do so before expiration of term. The implied covenant fairly to exhaust capability of the land to produce mineral subsists. If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."

In Brewster vs. Lanyon, supra, the court (page 813) said, "In the absence of some stipulation to that effect, we think an oil and gas lease cannot be said to make the lessee the arbiter of the extent to which, or the diligence with which, the exploration and development shall proceed. The operations contemplated, in the event oil and gas are found in paying quantities, are not to be likened unto a business into which one puts property, money, and labor exclusively his own, the profits and losses in which are of concern only to him, and the conduct of which may be according to his own judgment, however erroneous it may be. By reason of the conditions on which the lease is granted the lessor retains at least a contingent interest in the oil and gas, to the

profitable extraction of which the operations are directed. This interest in the subject of the lease, and the fact that the substantial consideration for the grant lies in the provisions for the payment of royalties in kind and in money on the oil and gas extracted, make the extent to which and the diligence with which the operations are prosecuted of immediate concern to the lessor. If they do not proceed with reasonable diligence, and by reason thereof the oil and gas are diminished or exhausted through the operation of wells on adjoining lands, the lessor loses, not only royalties to which he would otherwise be entitled, but also his contingent interest in the oil and gas which thus passes into the control of others. The object of the operations being to obtain a benefit or profit for both lessor and lessee, it seems obvious, in the absence of some stipulation to that effect, that neither is made the arbiter of the extent to which or [fol. 40] the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable. This is the rule in respect of all other contracts where the time, mode, or quality of performance is not specified, and no reason is perceived why it should not be equally applicable to oil and gas leases. There can, therefore, be a breach of the covenant for the exercise of reasonable diligence, though the lessee be not guilty of fraud or bad faith."

I am compelled to conclude that the defendant in the instant case has not shown that diligence and exploring and developing the land in question as is required under the law, equity, and good conscience and therefore conclude as a matter of law that:

Conclusions of Law

1. Under the facts and circumstances in this case, as shown by the evidence and the record, the plaintiffs, have no adequate remedy at law.

2. The defendant and its predecessors in title have not in good faith and with reasonable diligence explored and developed the lands described in this lease in accordance with the express and implied covenants of said lease.

3. It would be inequitable and unjust to permit the defendant to hold, keep, and retain the leasehold property involved herein without further exploration or development,

as said defendant proposes to do, as shown in the pleadings and evidence herein.

4. The plaintiffs, under the evidence, are entitled to a judgment of this court canceling said lease as to all the land described therein except the southwest quarter of the southeast quarter of the southwest quarter of said section Sixteen (16) upon which the two offset wells heretofore mentioned were drilled and developed by defendant or its predecessors in title.

5. The defendant is entitled to hold and enjoy its leasehold rights upon said ten acres of land described in Conclusions of Law No. 4 herein so long as it produces gas or oil therefrom in paying quantities.

6. I find each and all the other issues of law involved herein in favor of the plaintiffs and against the defendant, [fol. 41] to all of which findings and conclusions and each, every part thereof the defendant objects and excepts and its exceptions are allowed.

Richard J. Hopkins, Judge.

[File endorsement omitted.]

In United States District Court

Decree—Filed September 15, 1932

Heretofore, on the 8th day of June, 1932, the above entitled cause came regularly on for trial at Kansas City, Kansas, and the above named plaintiffs appeared by their attorneys, W. L. Huggins and Ray S. Pierson, and the above named defendant appeared by its attorneys, Douglas Hudson and R. H. Wills, and the said cause proceeded regularly to trial, and at the close of said trial, on the 9th day of June, 1932, said cause was taken under advisement; and heertofore, to-wit: on the 25th day of July, 1932, the court filed in said cause its memorandum decision; and

Now, on this 14 day of September, 1932, pursuant to the court's aforesaid memorandum decision, It Is Ordered, Adjudged and Decreed that the certain oil and gas lease which was executed by Philip Sauder and Annie Sauder, his wife, to W. A. Moon and to J. W. Phillips, covering the E½ and

the SE¼ of the SW¼ of Section 16, Township 23, Range 13, containing 360 acres, more or less, in Greenwood County, Kansas, and which said lease was filed for record on the 4th day of November, 1916, and recorded in Book 3 of Oil and Gas Records at page 440 of the Records of the Register of Deeds of Greenwood County, Kansas, be and the same is hereby cancelled, set aside and held for naught, save and except insofar as the same covers the following described real estate and premises, to-wit:

That part of the SE¼ of the SW¼ of Section 16, Township 23, Range 13, in Greenwood County, Kansas, described as follows: Beginning at the Southwest corner of the aforesaid SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence East 860 feet along the South line of said SE¼ of the SW¼, thence North 400 feet, thence West 860 feet to the West line of said SE¼ of the SW¼, thence South along said West line 400 feet to the point of beginning.

[fol. 42] It Is Further Ordered, Adjudged and Decreed by the court that as to the real estate and premises last described, to-wit:

That part of the SE¼ of the SW¼ of Section 16, Township 23, Range 13, in Greenwood County, Kansas, described as follows: Beginning at the Southwest corner of the aforesaid SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence East 860 feet along the south line of said SE¼ of the SW¼, thence North 400 feet, thence West 860 feet to the West line of said SE¼ of the SW¼, thence South along said West line 400 feet to the point of beginning,

the above described oil and gas mining lease shall be and continue in full force and effect, as long as oil or gas is produced in paying quantities from said last described real estate and premises.

To the above and foregoing decree, and each and every part thereof, the defendant excepts and its exception is allowed.

Richard J. Hopkins, Judge.

O. K. as to form: W. L. Huggins and Ray S. Pierson, Attorneys for Plaintiffs.

[File endorsement omitted.]

In United States District Court

Decree—Filed October 20, 1932

Heretofore, on the 8th day of June, 1932, the above entitled cause came regularly on for trial at Kansas City, Kansas, and the above named plaintiffs appeared by their attorneys, W. L. Huggins and Ray S. Pierson, and the above named defendant appeared by its attorneys, Douglas Hudson and R. H. Wills, and the said cause proceeded regularly to trial, and at the close of said trial, on the 9th day of June, 1932, said cause was taken under advisement; and heretofore, to-wit: on the 25th day of July, 1932, the court filed in said cause its memorandum decision; and

Now, on this 7th day of October, 1932, pursuant to the court's aforesaid memorandum decision, It Is Ordered, Adjudged and Decreed that the certain oil and gas lease which was executed by Philip Sauder and Annie Sauder, his wife, to W. A. Moon and J. W. Phillips, covering the E½ and the [fol. 43] SE¼ of the SW¼ of Section 16, Township 23, Range 13, containing 360 acres, more or less, in Greenwood County, Kansas, and which said lease was filed for record on the 4th day of November, 1916, and recorded in Book 3 of Oil and Gas Records, at page 440 of the Records of the Register of Deeds of Greenwood County, Kansas, be and the same is hereby cancelled, set aside and held for naught, save and except insofar as the same covers the following described real estate and premises, to-wit:

That part of the SE¼ of the SW¼ of Section 16, Township 23, Range 13, in Greenwood County, Kansas, described as follows: Beginning at the Southwest corner of the aforesaid SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence East 860 feet along the South line of said SE¼ of the SW¼, thence North 400 feet, thence West 860 feet to the West line of said SE¼ of the SW¼, thence South along said West line 400 feet to the point of beginning.

It is further ordered, adjudged and decreed by the court that as to the real estate and premises last-described, to-wit:

That part of the SE¼ of the SW¼ of Section 16, Township 23, Range 13, in Greenwood County, Kansas, described as follows: Beginning at the Southwest corner of the afore-

said SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence East 860 feet along the South line of said SE¼ of the SW¼, thence North 400 feet, thence West 860 feet to the West line of said SE¼ of the SW¼, thence South along said West line 400 feet to the point of beginning.

the above described oil and gas mining lease shall be and continue in full force and effect, as long as oil or gas is produced in paying quantities from said last described real estate and premises.

It is further ordered, adjudged and decreed by the court that the tanks, pipes and equipment now located on the Southeast Quarter of the Southwest Quarter of Section 16, Township 23, Range 13, in Greenwood County, Kansas, at a point approximately 800 feet north of the south line of said above described tract used in the operations of the defendant in connection with the two wells now producing oil and gas upon the above described excepted tract shall be allowed to remain there at their present location unless [fol. 44] the location of said tanks, pipes and equipment shall become obstacles in the development of the lands where said tanks and pipes are located for oil and gas purposes by the plaintiffs, and in that event the defendant shall be required to remove said tanks, pipes and equipment within the limits of the tract of real estate hereby excepted from this decree of cancellation.

To the above and foregoing decree, and each and every part thereof, the defendant excepted and excepts and its exceptions are allowed.

Richard J. Hopkins, Judge.

O. K. as to form: W. L. Huggins, Ray S. Pierson, Attorneys for Plaintiffs. R. H. Wills, Douglas Hudson, Attorneys for Defendant.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

Statement of the Evidence, as Required by Equity Rule No. 75—Filed Nov. 1, 1932

Be it Remembered, That the above entitled cause came regularly on for trial before the court sitting in equity on

the 8th day of June, 1932, upon the issues formed by the pleadings in said cause; Ray S. Pierson, W. L. Huggins and L. W. Reynolds appearing as counsel for the plaintiffs, and R. H. Wills and Douglas Hudson appearing as counsel for the defendant.

STATEMENT OF COUNSEL

Thereupon, counsel for plaintiffs made his opening statement to the court, and in the course thereof stated in substance, among other things, that the action was commenced for the cancellation and forfeiture of an oil and gas lease in what is known as the Gridley oil field; that Phillip Sauder was the owner of the land involved in his lifetime; that he died intestate and that the present plaintiffs were his sole and only heirs at law, and the plaintiff, Annie Sauder, is the duly appointed, qualified and acting administratrix of his estate; that the lease involved herein covers 360 acres of land and was executed by Mr. Sauder to W. A. Moore and J. W. Phillips on the 6th day of June, 1916, for a period of ten years, and as long thereafter as oil or gas was produced from the leased premises in paying quantities; [fol. 45] that thereafter said lease by mesne conveyances became the property of the Mid-Continent Petroleum Corporation, the defendant herein; that there was no development on said lease until 1921, when an offset well was drilled in the southwest corner of said lease, and in 1922 another offset well was drilled in the same part of the leased premises; that the initial production of well No. 1 was 75 barrels per day and the initial production of well No. 2 was 20 barrels per day; that in the plaintiffs' petition we allege that a few days after the ten year term of the lease expired in 1926 Mr. Sauder wrote a letter to the Mid-Continent Petroleum Corporation, in which he demanded that something be done about it, and he called its attention to the fact that the ten year term had expired and it had not produced anything except the two little offset wells, and stated that if it was not going to produce, he wanted it to release the lease; and that the Mid-Continent Petroleum Corporation admits that it received said letter and it replied that it regarded the lease valuable and would not release it and made no promise of development; and that there was nothing in defendant's answer that promised development or anything of that kind; that no rentals

had been paid under the terms of the lease since the drilling of the first well in 1921 and that from 1921 until the present time the wells had decreased in production so that the income from the wells was very far below what the rental of $1.00 per acre would be if the defendant paid that.

Counsel for plaintiffs also stated:

"Now, I think the evidence will show there is good reason to believe that this is oil bearing land, because of the development around it which will be shown by this map and I will not take time now to go into that. However, the evidence will also show that in this field there are spots where there is oil and also spots where there is not oil and it is a field where it is impossible to tell whether a development of this lease would have yielded profits or would not have, and it is one of those cases where it is impossible to establish by geology, because it is too speculative, and the only resort we have is to cancel the lease and there is no adequate remedy except a cancellation that we know of."

[fol. 46] STATEMENT OF COUNSEL.

Thereupon counsel for defendant made his opening statement to the court, and in the course thereof stated:

"Our position is this: That the Mid-Continent Petroleum Corporation and its predecessors have complied with both the express and implied obligations of this lease, both with reference to drilling of the offset wells, and also with reference to further development. That being true, and oil still being produced in paying quantities, we say the lease is still in full force and effect. * * *"

Counsel for the defendant further stated:

"The answer in this case admits most of their allegations and there is just the one question, as I see it, whether or not, under the existing circumstances, there was any obligations for us to drill an additional well or wells and of course, evidence as to that has to be put on."

Counsel for the defendant further stated:

"My notion is this, that they have to establish by their proof that there was or has been a breach, of either the

expressed or implied obligation to drill an additional w
If they don't do that, why, under the terms of the le
and the law, the lease continues as long as the lease p
duces in paying quantities and when it ceases to prod
in paying quantities, it is, ipso facto, at an end."

STIPULATION RE LESSOR'S TOTAL RECEIPTS

Thereupon it was stipulated by and between the part
that the lessors total receipts under the lease involv
which represented 1/8th of the total amount of oil produ
from and under said lease was $766.50 for the year 19
$658.45 for the year 1928; $623.90 for the year 19
$495.45 for the year 1930; $239.23 for the year 1931; a
for the year 1932 up to the date of trial an average of $21
or $22.00 per month.

Thereupon plaintiffs introduced in evidence their Exhi
No. 1, which it was admitted shows the wells drilled up
the lands involved herein, and the lands surrounding sa
the location of said wells, date of drilling, depth and init
production thereof. The same was admitted without
jection.

Thereupon counsel for the plaintiffs stated to the cou

"The evidence will show, if you want it, that all t
[fol. 47] field in Greenwood County, that the producti
after three or four years goes down very rapidly."

STIPULATION RE DEFENDANT'S EXHIBITS "A", "B" AND "C

Thereupon it was stipulated that defendant's Exhib
A, B and C might be considered in evidence, and that t
same were substantially correct statements of the pres
amount of oil and water being produced from each of t
wells upon the following leases:

Howell & Shaffer lease covering the Northwest Quart
(NW1/4) of Section Fifteen (15), Township Twenty-thr
(23), Range Thirteen (13);

Q. M. Shadel lease, covering the Southwest Quar
(SW1/4) of Section Fifteen (15), Township Twenty-thr
(23), Range Thirteen (13);

Phillip Sauder lease, being the lease involved in the case at bar;

Florence Oil Company lease, covering the West Half (W½) of the Southwest Quarter (SW¼) and the Northeast Quarter (NE¼) of the Southwest Quarter (SW1/2) of Section Sixteen (16), Township Twenty-three (23), Range Thirteen (13);

Wells Nos. 2 and 4 on the Viola M. Griblin-A lease, covering the Northwest Quarter (NW¼) of Section Twenty-one (21), Township Twenty-three (23), Range Thirteen (13); and

Theta Oil Company lease, covering the West Half (W½) of Section Ten (10), Township Twenty-three (23), Range Thirteen (13):

that said figures represented the daily average for approximately fifteen days prior to the date of said statements; and that there was a well being drilled at the time of the trial of the case at bar one-half mile north and 700 feet east of the east line of the involved property, and that said well was down at that time about 1,100 feet.

Thereupon the plaintiffs rested.

DEMURRER TO PLAINTIFFS' EVIDENCE

Thereupon the defendant demurred to the plaintiffs' evidence for the reason that it wholly failed to establish a [fol. 48] cause of action in favor of the plaintiffs, or any of them, against the defendant; the ruling upon which was held in abeyance by the court.

Thereupon GEORGE O. MOODY was called as a witness on behalf of the defendant, and testified on direct examination as follows:

That he was Vice-President in charge of production of oil and gas for the defendant, Mid-Continent Petroleum Corporation, and had been engaged in the oil and gas business about 32 years, in the development and operation of oil and gas of wells in Pennsylvania, West Virginia, Illinois, Kansas, Texas, Oklahoma, Borneo, Rumania and

Sumatra; that he was engaged in such business in Kansas and Oklahoma for a short time in 1906 and came back in 1916 and had been engaged in such business in both Kansas and Oklahoma continuously since 1916; that he was familiar with the lease involved herein; that the total revenue in oil produced from said lease down to the 31st day of December, 1931, and accruing to the lease operator, representing 7/8ths of all the oil produced, was $72,694.18; that the royalty paid to the lessors in said lease was between $9,000.00 and $10,000.00, or 1/7th of the aforesaid sum; that up to the present time there had been a total expenditure of $46,464.97 in connection with the drilling, equipping and operation of the two wells on said lease; that down to the first day of January, 1932, said lease had shown a profit to the Mid-Continent Petroleum Corporation of $26,229.21, which had been accumulated from the time the aforesaid wells were drilled in 1921 to December 31, 1931; that the average rate of earning produced by said lease, on the basis of the expenditures, was approximately 5.1% per annum; that that return was very small in so far as an oil venture was concerned because in the development for oil and gas the hazards are so great one must plan a larger return on invested capital on account of dry holes which never give any return; that it cost approximately between $15,000.00 and $16,000.00 per well to drill and equip a well in the locality of the lease involved, and that that was the approximate cost of drilling and equipping each of the wells on said lease; that the Mid-Continent Petroleum Corporation owned three leases on property adjacent to the lands covered by the lease involved herein; that it owned what [fol. 49] was known as the Viola M. Griblin-A lease covering the Northwest Quarter (NW¼) of Section 21, Township 23, Range 13, which has been producing since 1921; that the percentage of interest on the expenditures in connection with the development and operation of said lease was approximately 6.8% per annum; that it owned the Viola M. Griblin B lease covering the Northeast Quarter (NE¼) of Section 21, Township 23, Range 13, and that it had drilled one well on said lease; that it owned the Q. M. Shadel lease covering the Southwest Quarter (SW¼) of Section 15, Township 23 South, Range 13 East, which it purchased after production was obtained thereon, and for that reason defendant did not have the complete figures

showing the percentage of profit that had been derived from the operation of said lease; that it had the figures since 1924 or 1925; that the same was also true of the Viola M. Griblin-B lease and the C. M. Shambaugh lease covering the Northwest Quarter (NW¼) of Section 22, and which was also owned by defendant; that the wells located along the east line of the lease involved, and shown on plaintiffs' Exhibit No. 1, were producing from two geological stratas, one called the Bartlesville Sand and the other the Mississippi Lime; that the major portion of said wells were producing from the Bartlesville Sand; that none of said wells to the east of the lease involved was drilled any closer than 660 feet from the east line of the said lease, because as they went west with the locations the oil decreased in volume and the water increased, showing that they were reaching the edge of the pool; that the development to the east demonstrated that the oil producing sand plays out before it reaches the east line of the lease involved; that in his opinion in going west one location from any of the wells east of said lease one could get a dry hole; that in this neighborhood the customary distance between wells is between 500 and 600 feet; that Shaffer and Howell owned the lease covering the Northwest Quarter (NW¼) of Section 15, Township 32, Range 13, and that the Mid-Continent Petroleum Corporation had no interest whatever in said lease; that the closest well on said lease to the east line of the lease involved was well No. 4, which was 660 feet from said line, and that there was sufficient distance between that well and the east line of the lease involved to have drilled an additional well; that is also true of all the wells located along the west side of the Shaffer & [fol. 50] Howell lease and that all the other wells along the west side of the Shaffer & Howell lease were a greater distance from the east line of the lease involved than said well No. 4 in the northwest corner of said lease; that well No. 2 on the Theta Oil Company lease covering the Southeast Quarter (SE¼) of Section 9, Township 23, Range 13, shown on plaintiffs' Exhibit No. 1, was a dry hole; that said well was drilled below 2,200 feet; that the Bartlesville Sand was encountered in this field between 1,500 and 1,600 feet, and that the Mississippi Lime in this locality, from which

some of the wells were producing, was encountered at approximately 1,700 feet, or beneath the Bartlesville Sand; that the Theta Oil Company well No. 2 was drilled to the Mississippi Lime and through the Bartlesville Sand, and that no production was obtained in said well, in either the Bartlesville Sand or the Mississippi Lime; that the well immediately south of the Theta No. 2 on the Northeast Quarter (NE¼) of Section 21, being well No. 1 on the Viola M. Griblin-B lease, was drilled through the Bartlesville Sand to the Mississippi Lime and that the Bartlesville Sand encountered was very broken and in a small amount and no production was obtained in said sand, and that only a very small production was obtained in the Mississippi Lime; that said well has not produced sufficient oil to repay the cost and expense of drilling and equipping it and that it probably never will pay out; that Theta well No. 2 and Viola M. Griblin-B No. 1, which are in a direct north and south line, tend to show that the probabilities are there is no Bartlesville Sand under the lease involved; that the Mid-Continent Petroleum Corporation drilled well No. 1 on the Viola M. Griblin-B lease and that the purpose of drilling that well was because there was a large undeveloped area between the two pools and that it went between the two pools to see whether there was any connection or production between them, and that said well No. 1 on the Viola M. Griblin-B lease gave the information that there was not enough oil to pay; that said well and the history of it had a great deal to do with defendant not having drilled additional wells on the lease involved; that Theta well No. 2 and Viola M. Griblin-B well No. 1, in the first of which no lime oil was found and in the second of which only a very small quantity of lime oil was found, tended to prove there was either no oil or only oil in too small a quantity to pay, in the Mississippi Lime under the lease [fol. 51] involved, and that that had a great deal to do with not drilling additional wells on said lease; that taking the facts shown by the map introduced in evidence as plaintiffs' Exhibit No. 1 into consideration, in his opinion the sand from which the wells east of the lease involved are producing, like the sand in all oil producing areas in that part of Kansas, was a long narrow strip, usually two and not more than three locations wide, and so long and so narrow that it was generally spoken of as a shoestring sand; that

one usually got better results by drilling in the middle of that line of sand, and by going either east or west one usually got smaller wells; that all of the wells which had been drilled to the west of the lease involved were producing from the Mississippi Lime and that all of said wells were drilled through the Bartlesville Sand, or where the Bartlesville Sand is ordinarily encountered, but that none of said wells west of the lease involved ever produced from the Bartlesville Sand; that well No. 1 on the lease involved is located in the extreme southwest corner of said lease and the initial production of said well was approximately 75 barrels; that well No. 2 was to the east of well No. 1, and that the initial production of said well was approximately 20 barrels; that that indicated that if defendant had extended the development further east it would have gotten a dry hole; that taking into consideration the development both upon the lease involved and upon all surrounding leases, both east and west and north and south, the cost of drilling and equipping a well in that locality and the probability of encountering paying production, and all other available facts, it was his opinion that no prudent operator would have drilled another well on the lease involved; that the Mid-Continent Petroleum Corporation had never abandoned any portion of the lease involved and had never intended to abandon any portion of it, and that if the future should prove it practical to drill another well on said lease the Mid-Continent Petroleum Corporation was capable and willing to drill it; that there was a dry hole on the Florence Oil Company lease in the Southwest Quarter (SW¼) of the Southwest Quarter (SW¼) of Section 16, just one location from the lease involved; that said well was drilled to the Mississippi Lime and through where the Bartlesville Sand should have been; that there was a dry hole drilled on the East Half (E½) of the Northwest Quarter (NW¼) of Section 16 by the Syndicate Oil Company, and that said well was drilled through where the [fol. 52] Bartlesville Sand should have been and then to the Mississippi Lime, and said hole is a little more than one location from the lease involved; that said wells indicate that it was improbable that oil would be obtained on the lease involved; that the amounts of oil produced from the wells to the east of the lease involved and nearest the east line of said lease were declining rapidly and the

amount of water was increasing; that said wells were making more water than the wells to the east of them; and that that fact indicated that the west edge of the pool from which said wells were producing had probably been reached, and that the wells just east of the east line of the lease involved were edge wells.

On cross-examination the witness testified that it was his contention that the half section of land covered by the lease involved was worthless from the standpoint of future development, unless some future development proved that defendant's present theories were wrong; that the development on said lease makes the lease worth more than $3,000.00, but all that he could testify to was his opinion, formed from practical experience and watching developments; that by future development he meant that if there was any development in the vicinity that showed defendant's present theory of operation was wrong; that if some other company does any drilling in the vicinity, which indicates that there might be oil on the land involved, the defendant would drill an additional well or wells on said land; that the defendant's geological records showed that the lime was high on the Griblin lease where there are several producing oil wells, and that it stops there, but that said records did not show that it was impossible for further development in the northwest corner of the lease involved; that the development around the northwest corner of said lease had not been as thorough as around the edges of it, and that if it was later developed that production could be obtained there the defendant would be perfectly willing to develop further on the lease involved; that before there was any further development on the lease involved the defendant would have to gain further information; that further information would be obtained by geology and drilling to the northwest; that the defendant had no leases to the northwest of the lease involved, but might obtain further information if someone else happened to drill to the northwest of the lease involved; that most of the wells drilled on the surrounding leases owned by the Mid-Continent Petroleum Corporation were drilled before [fol. 53] it acquired the leases; that the leases were developed by the Atlantic Petroleum Corporation and the Ralco Company; that he had forgotten how many wells the Mid-Continent Petroleum Corporation drilled.

The foregoing cross examination consists, in part, of the following questions and answers which are inserted herein at the request of counsel for the plaintiffs:

Q. Then, if your geological record shows the west half is worthless, are you willing to cancel it and use the forty acres?

A. Our geological records show it is not impossible for further development in the northwest corner of the lease.

By the Court: I didn't hear you.

A. The development around the northwest corner of the lease has not been as thorough as around the edges of it and if that is later developed, we would be perfectly willing to develop it.

By the Court: Somebody else would have to develop it?

A. We would have to gain further information than we have.

By the Court: How would you get that?

A. Geology.

By the Court: Your theory and your contention and the purpose of your company, is to hold this lease without any further development, or until somebody else develops something that might indicate to you——(Interruption.)

A. Or we gained further information ourselves.

Thereupon the court took an adjournment until 10:00 A. M., June 9th, 1932, when the trial of the case was resumed, and thereupon George O. Moody, being recalled for further cross-examination, testified as follows:

That the Mid-Continent Petroleum Corporation had no immediate intentions of further developing the lease involved.

On re-direct examination, the witness testified that oil was discovered in paying quantities in each of the two [fol. 54] wells drilled on the lease involved, and that said wells had been operated continuously down to the present time, and were still being operated, and that said wells have at all times produced and are now producing oil in sufficient quantities to produce a profit over and above the cost of operation; that none of said wells located to the

east of said lease is what is known as an "offset well"; that the usual location distance from the line for wells in this locality was approximately 200 feet, and that as a general proposition the distance between the wells was approximately 500 feet or a little more; that none of the wells drilled along the east side of the lease involved was within 500 feet of the east line of said lease, and that there was sufficient space for the location of another well between each of said wells and the east line of said lease; and that if another well was located there there would still be the usual distance between said well and the east line of the said lease.

On re-cross examination the witness testified that if a paying well was drilled within 200 feet of the involved lease the defendant would be compelled to give plaintiffs an offset well; that the reason the Mid-Continent Petroleum Corporation had not drilled closer to the involved lease along the east on the Shadel lease was because it would not get oil in paying quantities; that it had gone west on the Shadel lease as far as it thought it could; that he supposed his theory could be wrong; and that defendant had no immediate intentions of drilling around the involved lease.

Thereupon LLOYD SNYDER, called as a witness on behalf of the defendant, testified, on direct examination, as follows:

That he was employed by the Mid-Continent Petroleum Corporation as District Superintendent of Production in northern Oklahoma and in Kansas, and that he had charge of the involved lease; that he had been Superintendent of Production for the Mid-Continent Petroleum Corporation in this particular locality for thirteen years; that he had been engaged in the drilling of oil wells and operating and producing them for thirty-three years; that his experience for the most part had been in West Virginia, Kansas, Oklahoma and Texas, and that he had been engaged in the oil business in Kansas and Oklahoma for seventeen years; that the power with which the two wells on the involved lease were operated since they were brought in in 1921 and [fol. 55] 1922 was not located on the involved lease, but was

on the Griblin lease to the south of the involved lease; that he was familiar with the wells which had been drilled to the east of the involved lease and that said wells were not close enough to the lease involved to be what are commonly called "offset wells" to said lease; that the closest producing well to the east line of the lease involved is well No. 4 on the Shaffer & Howell lease and it is 660 feet from the east line of the lease involved; that the usual distance between wells in this locality is 460 feet, staying 200 feet from county lines anl lease lines; that some of the locations in this field are 520 feet apart; that the wells to the east of the involved lease are producing from the Bartlesville Sand and that the wells to the west and southwest of said lease are producing from the first break in the Mississippi Lime, which is below the Bartlesville Sand; that there were no wells anywhere around the lease involved on adjoining properties which could be called "offset wells"; that the Mid-Continent Petroleum Corporation owned a lease on the Southwest Quarter (SW¼) of Section 15, the Shadel lease, and that the Ralco Oil Company drilled four wells and one dry hole; that the Mid-Continent Petroleum Corporation had not extended its development further west on the Shadel lease because, in his opinion, and in the opinion of the officials of the Company, no prudent operator would have developed it further west, and that he based his opinion upon the water encroachment and the thickness of the sand; that as they went further west on the shoestring line of sand they developed more water and that was an indication that the producing sand was playing out; that as they went further west the production was smaller and they had been advised that the same was true on the Shaffer & Howell lease to the north of the Shadel lease; that it was his opinion that it would not have been profitable to have drilled an additional well on any portion of the involved lease and that if additional wells had been drilled on said lease oil or gas would not have been discovered in such quantities as to have repaid the total outlay, together with a reasonable profit on that outlay, and that in his opinion no prudent operator would have drilled an additional well on the involved lease; that as they drilled the wells on the Shadel lease the center line of wells had a thicker body of sand and more production, and that as they went either east or west from that center line of wells the sand was

thinner and non-productive to a certain extent; that there [fol. 56] was no oil in the top of it and there was water in the bottom of it; that from these facts, as an operator, it was his opinion that if they had gone another location or half a location west, they would have missed the sand entirely and struck a dry hole; that defendant's well No. 1 on the involved lease showed an initial production of 75 barrels, with a certain thickness of sand, and well No. 2, to the east of it, showed a thin sand and a very small amount of oil, and from those facts he drew the conclusion that if they had gone further east they would get the lime and it would have been non-productive and would not have paid to drill a well; that the Atlantic Petroleum Corporation drilled a well on the Viola M. Griblin-B lease in the Northeast Quarter (NE¼) of Section 21, and that said well was drilled through the sand into the lime; that it did not produce oil in paying quantities, but was still being operated by the Mid-Continent Petroleum Corporation, and in his opinion it would never pay out; that the well drilled immediately north of that well on the Theta Oil Company lease in the Southwest Quarter (SW¼) of Section 9, was a dry hole and was drilled through the sand into the lime; that that well and the Viola M. Griblin-B well to the south had a tendency to show that lime oil did not extend that far west on the involved lease; that the sand was missing in both of said wells; and that shows that in that direct line north and south one could not get paying production either in the sand or in the lime.

On cross-examination the witness testified that there were no offsets to the lease involved except the two wells on the Griblin-A lease and the Florence Oil Company well in Section 16; that in his opinion it would not have been a prudent idea to have drilled any other offset well to the involved lease; that Shaffer & Howell owned a lease to the north of the Shadel lease, and that they had laid back from the line about 660 feet; that the Mid-Continent Petroleum Corporation and the Shaffer & Howell Company did not have and never talked of any agreement to lay back from the line and not give Mr. Sauder an offset well; that Shaffer & Howell used the same theory that prudent operators would have used; that Shaffer & Howell drilled fifteen wells on their lease, and that they have been pumping them ever since they have been drilled; that from the map it

looked as though there was a general trend from the southwest; that it stopped at the involved lease on the southwest and on over to the northeast of the lease involved the trend [fol. 57] goes right on north; that his reason for believing there was no oil on the lease involved between the producing wells to the southwest and those to the northeast of the lease involved was that as the defendant in drilling the wells it had already drilled went west from the trend of the wells to the east of the lease involved, the sand seemed to crop out, and that was also true of the wells in the southwest corner of the lease involved; that there were twenty-five wells drilled on the half section that corners the involved lease on the northeast; that the nine wells on the Viola M. Griblin-A lease were drilled in the Mississippi Lime and that the wells on the Shadel lease were drilled in the Bartlesville Sand and there has been one well on said lease drilled to the Mississippi Lime, which was a dry hole; that said well was drilled through the Bartlesville Sand and was practically dry, and the defendant drilled through to the first break in the Mississippi Lime, which was dry and the well was then plugged and shot in the Bartlesville Sand and made a small producer; that the Mid-Continent Petroleum Corporation did not drill a well to the north of the Sauder No. 1 well because it would have been an offset to a dry hole; that the wells on the lease involved had been pumped ever since they were drilled but that they were not very good now; that the wells in this vicinity had not been producing long enough to determine the average life of the wells; that they had not returned much dividend on the investment; that from a geologist's point of view the apparent trend which came toward the lease involved from the southwest seemed to stop before it reached the lease involved; that defendant had never drilled to find out but that was its theory; that he did not want to tell the court that he could tell where there was oil; that it was possible but not probable that its theory might be wrong; that as a general rule the Bartlesville Sand in the vicinity of the lease involved did not run from the southwest to the northeast; that it was his knowledge as an operator that the apparent trend stopped when it got to the lease involved; that the field ran up to the County line quite a distance north of the lease involved; that for a distance of five miles the only break in the line is on the lease involved;

that it was just as possible for production to stop on the lease involved as at any other place; that the Base lease in Section 5, Township 23, Range 13, produced for eight or nine years but was now abandoned; that the wells produced a great deal of water; that as a rule oil trends did not run [fol. 58] in an exactly straight line; that he believed the well on the Viola M. Griblin-B lease had not paid for operation and that the lease had not paid; that the Cosden Oil Company and the Atlantic Petroleum Company did not drill most of the wells on the Shadel lease; that the defendant drilled six wells and the Ralco Oil Company drilled four wells; that the defendant completed its first well on the Shadel lease on October 11, 1923; that he did not consider that the company that the defendant merged with did most of the developing; that he did not think the ten wells on the Griblin-A lease were drilled by the Atlantic Petroleum Company; that he drilled all of the wells drilled on the Griblin lease after October 14th, 1923; that the defendant had drilled as many wells as other companies; that he did not think that the wells around the lease involved that had been pumping from eight to eleven years were draining oil from under the lease involved; that he did not think there was any producing sand under the lease involved; that even if there was oil under said lease from the location of the wells they would not drain the oil from under it; that the wells around the lease involved might possibly lower the pressure; that whether or not drilling an offset to a producing well would lower the production of a producing well depended on the body of sand it was producing from, and whether it was a small body of sand or a large one; that he would consider the body of sand to the east of the lease involved a very small body of sand; that if there were oil on the lease involved the wells surrounding said lease would necessarily lower the pressure, but that he did not think there was any sand on the lease involved; that he did not consider the defendant had been draining oil from under the lease involved; that for perfect drainage wells were placed 460 feet apart and 200 feet from the lease lines, and that there had been no wells drilled that would drain the lease involved; that he thought there were ten wells drilled on the northeast quarter of Section 22; that there was some lime oil to the east of the property shown on plaintiff's Exhibit 1; that oil had been

produced in Greenwood County for years; that the production from the wells drilled showed that the trend from the southwest stopped abruptly at the southwest corner of the lease involved and began again immediately north of the lease involved; and that the defendant had drilled only two wells on the lease involved.

[fol. 59] On re-direct examination the witness testified that in the 33 years he had been engaged in the oil business he had never heard of any oil field in which the sand did not at some place play out and that he had never heard of any oil sand that didn't have definite limits; that the wells to the southwest of the Sauder lease were producing from the Mississippi Lime, and in drilling said wells no Bartlesville Sand was found; that some of the wells to the northeast were producing from the Bartlesville Sand and some from the Mississippi Lime; and that there was nothing to indicate any connection between the wells to the southwest and those to the northeast of the involved lease.

On re-cross examination, the witness testified that the defendant did not have any wells on the Griblin lease on the Northwest Quarter (NW¼) of Section 21, Township 23, Range 13, drilled in what is called the Burgess Sand; that the Burgess Sand lays between the Bartlesville Sand and the top of the Mississippi Lime; but that said wells were producing from the first break in the Mississippi Lime.

On re-direct examination the witness testified that the first break in the Mississippi Lime is found at a lower depth than where the Burgess Sand is encountered.

L. J. Young, called as a witness on behalf of the defendant, testified, in substance, as follows:

That he was a geologist in the employ of the Mid-Continent Petroleum Corporation and was a graduate of geology at the University of Michigan; that he had been employed as a geologist by the Mid-Continent Petroleum Corporation for 10 years; that he had personally examined the logs of all the wells that had been drilled in the immediate vicinity of the lands involved herein; that he had prepared a map or chart, defendant's Exhibit D, which was

offered in evidence and admitted without objection, showing the location and trend of the sand from which the wells to the east and to the northeast and the southeast of the lands involved were producing. Referring to defendant's said Exhibit D, the witness testified that he had prepared said Exhibit from the well logs of the wells drilled by the various companies on the lands shown on said Exhibit; that a well log was a log made up by the driller drilling the well and turned in to the well owner, which showed all of [fol. 60] the formations encountered; that the general direction of this sand was just a little east of north and it is a very narrow sand; that the red lines on said map extending through the middle of the black lines indicate the crest or the highest point at which the drillers found the sand in drilling the wells and that as you go east from said red lines the sand is encountered at lower depths; that each of said black lines represents a drop of 10 feet; that the log trend was so made that it was a contour map on the top of the Bartlesville Sand and that it showed a dip both to the east and to the west from the center line and showed the sand in a long narrow trend; that said sand was called the Bartlesville Sand and was sometimes referred to as a shoestring trend, and was so called because it was narrow and extended for miles across the country; that the best wells were along the center line and that they decreased on each side as you went either way; that in his opinion, based upon an examination of the logs of the wells, the sand does not extend as far west as the involved lease, and that the 400 foot contour minus 400 feet below sea level takes in nearly all production and if they had gone below that they would have gotten a dry hole; that the map identified as defendant's Exhibit D was drawn solely with reference to the sand that was encountered to the east of the lands involved and had nothing to do with production from the lime; that in some cases when wells are marked dry on said exhibit it means dry only in the Bartlesville Sand; that the upper sand was encountered around 140 feet above the Mississippi Lime and the lower sand about 75 feet above said lime; that the figures on said map were obtained by first running the sea level elevation on all the wells and by taking the depth of the sand as recorded by the driller and subtracting the sea level elevation, which gave the distance below sea level at which the top of the sand was encountered; that said

figures are put on in minus quantities, the least distance below sea level being the higher point; that he had indicated the involved lease on the map by green pencil marks; that a circle with a dash through it on said map represented a dry hole, and a solid black circle represented a producing oil well; that the figures in red ink on some of the wells represented the thickness of the sand, where the well logs showed it; that he had also prepared a map or chart showing the location and trend of the Mississippi Lime in the locality of the involved lease, which was identified as de-[fol. 61] fendant's Exhibit E, and admitted in evidence, without objection; that the black lines on said map were the contour lines on top of the Mississippi Lime and that the map was designed for the purpose of showing the subsurface condition, particularly with reference to the Mississippi Lime, in the locality of the involved lease; that said map was prepared on the basis of the logs of the wells the same as defendant's Exhibit D, and indicated the involved lease in green crayon; that the black circles in ink on said map indicated the producing wells from the first break in the Mississippi Lime and the figures opposite said circles indicate the depth of the wells with reference to sea level; that said figures were greater than on defendant's Exhibit D because the lime lay below the horizon of the Bartlesville Sand; that he indicated the producing wells by a black circle and a dry hole by a circle with a line drawn through it; that he had also shown the location and trend of the Bartlesville Sand on said map by drawing two red lines and that the production from the Bartlesville Sand was within those lines. Referring to wells Nos. 1 and 2 on the involved lease, and well No. 1 on the Florence Oil Company lease to the west of the involved lease, the map shows a dip of 15 feet on the top of the lime between those three wells, going down toward the east or toward well No. 2 on the involved lease; that the dry hole on the Florence Oil Company lease on the Southeast Quarter (SE¼) of the Northwest Quarter (NW¼) of Section 16, was 32 feet lower on the top of the Mississippi Lime than Well No. 1 on the involved lease; that the lime under the involved lease was low and that it dipped in every direction except from the northwest to the southeast; that the production from the Mississippi Lime was obtained where the lime was encountered at high points and that the dry holes were obtained where the lime was en-

countered at the lower points; that in his opinion no paying production could be obtained from the Mississippi Lime at any point on the involved lease other than at the location of the two wells that had been drilled on said lease because the lease lies too low from the top of the Mississippi Lime for production; that he could not see any reason for thinking there was any oil at all on the land covered by said lease; and that the Bartlesville Sand did not extend far enough to the west to come to the Sauder property.

[fol. 62] On cross examination, the witness testified that he arrived at his conclusion by investigation and analysis; that in his testimony he had testified to facts that were developed by the drillers in drilling those wells and had used the logs of the wells made by them and if they had made any mistakes he would have made the same mistakes; that the oil development to the east of the involved lease and the drilling of those wells demonstrate that the sand was getting thinner and that it was going down and that in case it would curve to the west or to the east, where it might again get deeper, the wells away from the center of the sand would not get lower so rapidly; that he knew that from experience; that this particular field, known as the Gridley oil field, covers a good many sections of land and that to the north is what is called the Lamont oil field and that there were very few places in Greenwood County where the sand or trend has been very wide; that there were a good many strips in Greenwood County which were a considerable distance apart; that the oil in the Mississippi Lime where the high areas were ran in trends and that you could determine where the high areas were without boring down, by surface geology; that the surface geology follows the subsurface of the Mississippi Lime very closely; that he had never been on the lease involved; that his calculations shown on defendant's Exhibit D were, as near as he could make them, mathematically accurate; that the oil sand came closer to the involved lease immediately to the east than it did at any other point and that in his opinion the logs made by the drillers would not be inaccurate; that he would not say that the half section owned by plaintiffs was undoubtedly worthless from an oil standpoint, but that every indication they had so far on the geology showed it to be very low; that all of the black lines drawn on defendant's Exhibit E were based on knowledge he had received from the

logs of the wells that had been drilled and that his opinion as to how the Mississippi Lime laid under the involved lease was based upon the wells that had been drilled; that if a well had been drilled in the middle of lease involved he would have got some information he did not now have, and such a well might have changed to some extent Exhibit E; that oil in the Mississippi Lime is found on the highs and along the edges and does not run in trends unless the highs are in trends; that starting at the lower left hand corner of the map and going in a northeasterly direction until you [fol. 63] get to the involved land where the wells stop in the Mississippi Lime, then across the half section involved to the northeast, there was more oil in the Mississippi Lime; that there was nothing to indicate that there was a trend in the Mississippi Lime under the involved lease; that he had drawn a line between Well No. 2 on the involved lease and the half section line, which indicated that the lime would be encountered 10 feet lower there; that 10 feet does not shut out the possibility of obtaining oil, but that it meant a great deal; that the only way to be absolutely certain as to whether there were any high in the lime under the involved half section was by drilling a well; that he did not claim that a geologist could by the methods he had used determine whether there was oil under a certain piece of land and always be right; that he did not know of any cases in Kansas where a geologist had reported unfavorably and some one later got a good oil well; and that he had never condemned any areas as non-productive and afterwards found they were productive.

Thereupon G. O. Moody was recalled as a witness on behalf of the defendant and testified, on direct examination, in substance, that on the Q. M. Shadel lease the Ralco Company drilled four wells and the Mid-Continent Petroleum Company drilled six; on the C. M. Shambaugh lease the Ralco Company drilled eleven wells and the Mid-Continent Petroleum Corporation drilled one; on the Viola M. Griblin—B lease the Ralco Company drilled one well; on the Viola M. Griblin—A lease the Atlantic Petroleum Corporation drilled ten wells; and on the involved lease the Atlantic Petroleum Corporation drilled two wells.

No cross-examination.

Thereupon S. V. Brown was called as a witness on behalf of the defendant, and testified, on direct examination, in substance, as follows:

That he was Superintendent of the Shaffer & Howell Drilling Company, which owned the lease covering the Northwest Quarter (NW¼) of Section 15, Township 23, Range 13, and had been such a little more than ten years; that he had drilled all of the 15 wells on that lease with [fol. 64] the exception of two wells, and that he had drilled quite a number of wells to the north of the involved lease, and had drilled wells Nos. 18 and 2 on the T. F. Snyder lease in the next section, and drilled two wells offsetting those north of Section 15, and had drilled 18 wells in that section, and in the Southeast Quarter (SE¼) of Section 15 he had drilled 2 wells, and in Section 9 he had drilled 5 wells; that since the drilling of the wells on the Shaffer & Howell lease he had had charge of the operation of those wells and had determined the location for all of the wells on the Shaffer & Howell lease, with the exception of the first four wells; that well No. 4 on said lease was the closest well to the east line of the involved lease and that it was located in the northwest corner; that it had an initial production of approximately 60 barrels; that he had to put in 3 inch tubing and had around 300 barrels of water to handle in said well, and that the well now made in the neighborhood of 4 or 5 barrels; that he did not know whether or not the well had paid out, that none of the wells located on the Shaffer & Howell lease was an offset to the involved lease, and that the regular offset distance in this field was 200 feet from the property line; that the majority of operators in this field placed their wells 500 feet apart, but that the wells on the Shaffer & Howell lease were 360 feet apart; that there was room for approximately 5 or 6 locations along the west side of the Shaffer & Howell lease that had not been drilled; that the reason he had not drilled those locations was that the Bartlesville Sand ran through the property from the southeast to the northwest and that he was after sand oil; that they had a lime well in the northeast corner of their lease; that the Theta Oil Company well in Section 9 proved that the Bartlesville Sand did not extend for enough to the west to justify the drilling of those locations; that the trend of the sand on the Shaffer & Howell lease to the east of

the involved lease ran from the southeast to the northwest and that in his opinion there was no Bartlesville Sand on the said lease and that it would be necessary to find lime oil in larger quantities than he had found it to pay for the drilling of a well; that he never figured the lime ran in a trend like the sand and that he didn't think there was any lime oil on the involved lease; that he drilled well No. 7 in the southwest corner of the Shaffer & Howell lease and that it made about 2 barrels in the lime; that in his opinion a reasonably prudent oil man would not drill an [fols. 65 & 66] additional oil well on the involved lease; that the approximate cost of drilling and equipping a well in that locality, either to the Bartlesville Sand or to the Mississippi Lime, would be between $12,000 and $14,000; and that there was no connection at all between the Mid-Continent Petroleum Corporation and his employers and that he had no interest in this case.

On cross examination the witness testified that the closest he had ever drilled to the involved lease on the Shaffer & Howell lease was 660 feet from the line, and that there was no agreement of any kind between Shaffer & Howell and the Mid-Continent Petroleum Corporation; that Shaffer & Howell were pumping all of the wells on their lease, but that well No. 7 would not pay if they did not have the equipment on there; and that they had been pumping oil on the lease for the last ten years.

Thereupon the parties herein stipulated that the County line between Coffey and Greenwood counties was indicated by the figure 3 at the top of defendant's Exhibit E.

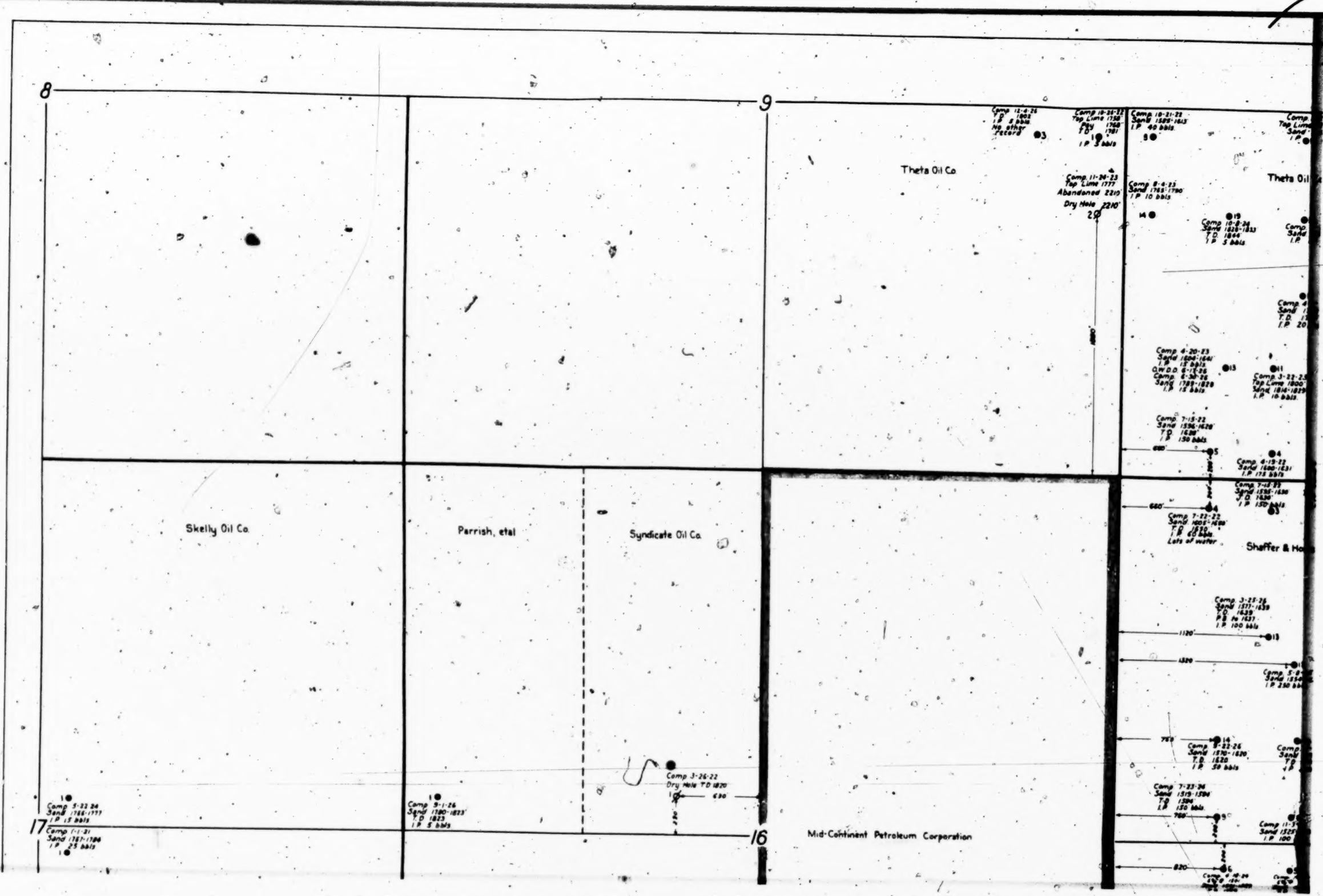
Thereupon the evidence was closed, whereupon the case was taken under advisement by the court.

Plaintiffs' Exhibits

Plaintiffs' Exhibit 1 was a map or plat showing the location of the wells drilled upon the lands in controversy, as well as upon adjoining lands, together with data in connection therewith, which plat or map is as follows:

PLAINTIFFS' EXHIBIT 1

(Here follows Exhibit 1, side folio 67)


8
9
17
16
Skelly Oil Co.
Parrish, etal
Syndicate Oil Co.
Theta Oil Co.
Mid-Continent Petroleum Corporation
Shaffer & Ho
Comp 5-22-26
Sand 1766-1777
I.P. 15 bbls
Comp 1-1-31
Sand 1787-1796
I.P. 25 bbls
Comp 9-1-26
Sand 1780-1823'
T.D. 1823
I.P. 5 bbls
Comp 3-26-22
Dry Hole T.D. 1820
Comp 12-4-26
T.D. 1902
I.P. 5 bbls
No other
Records
Comp 10-25-22
Top Lime 1750
Dry 1768
T.D. 1781
I.P. 3 bbls
Comp 11-24-23
Top Lime 1777
Abandoned 2215'
Dry Hole 2210'
Comp 10-21-22
Sand 1585-1613
I.P. 40 bbls
Comp 8-4-25
Sand 1765-1790
I.P. 10 bbls
Comp 10-2-26
Sand 1828-1833
T.D. 1844
I.P. 5 bbls
Comp 4-20-23
Sand 1604-1641
I.P. 15 bbls
O.W.D.D. 6-17-26
Comp 6-30-26
Sand 1781-1829
I.P. 15 bbls
Comp 3-22-25
Top Lime 1800
Sand 1814-1829
I.P. 10 bbls.
Comp 7-15-22
Sand 1596-1629
T.D. 1638
I.P. 150 bbls
Comp 6-19-22
Sand 1620-1631
I.P. 175 bbls
Comp 7-18-22
Sand 1595-1630
T.D. 1638
I.P. 150 bbls
Comp 7-22-22
Sand 1605-1630
T.D. 1820
I.P. 10 bbls
Lots of water
Comp 3-25-26
Sand 1577-1639
T.D. 1639
P.B. to 1631
I.P. 100 bbls
Comp 9-22-26
Sand 1570-1620
T.D. 1620
I.P. 50 bbls
Comp 7-23-26
Sand 1515-1594
T.D. 1594
I.P. 150 bbls
660'
1120'
1320'
760'
820'

Joint Exhibit #1
6-8-32
W.L.B.

9

10

16

15

Theta Oil Co

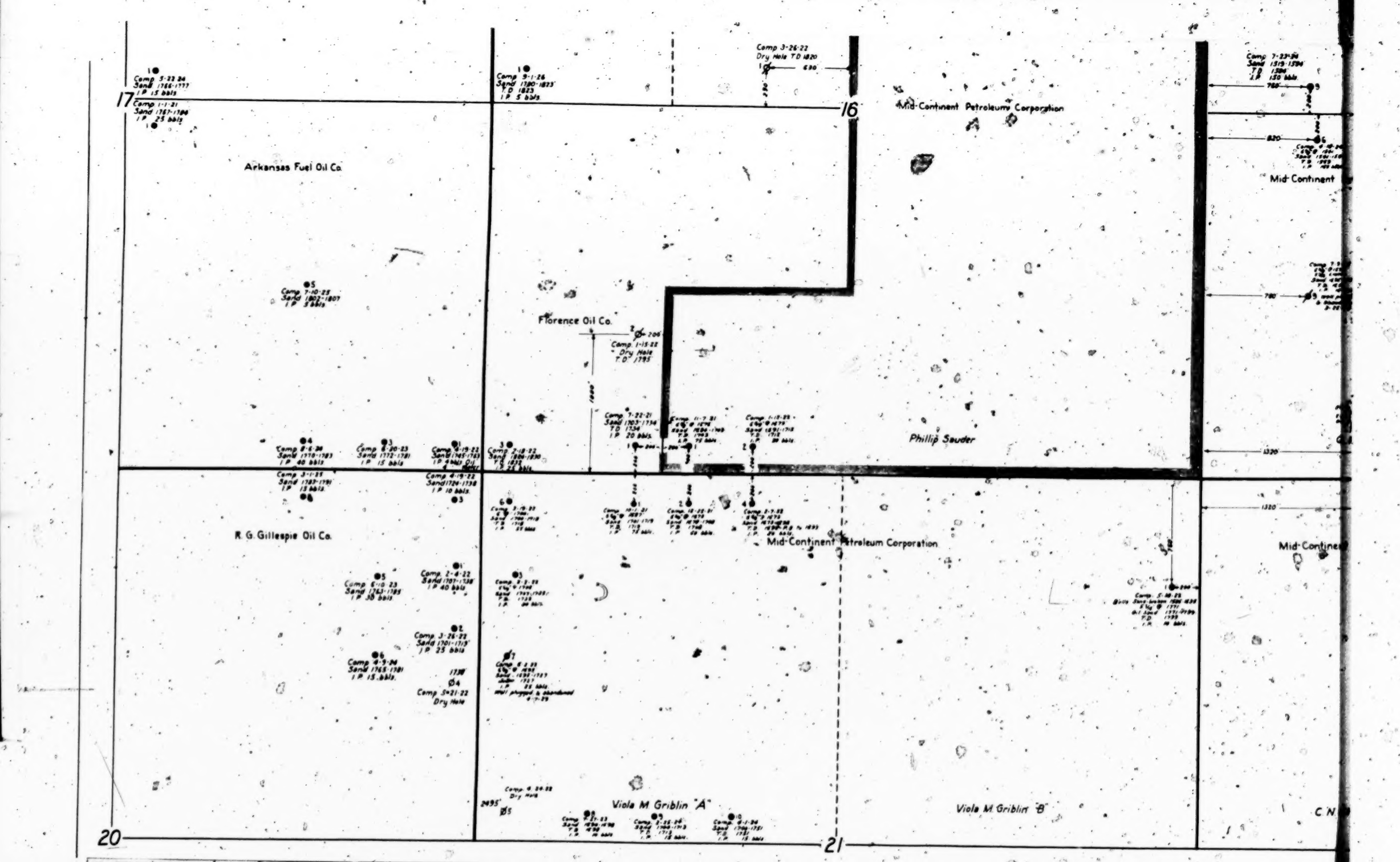
Theta Oil Co

Parrish, etal

Syndicate Oil Co

Shaffer & Howell

Mid-Continent Petroleum Corporation


17
16
20
21
Arkansas Fuel Oil Co.
Florence Oil Co.
Mid-Continent Petroleum Corporation
Phillip Sauder
Mid-Continent
R. G. Gillespie Oil Co.
Mid-Continent Petroleum Corporation
Mid-Continent
Viola M Griblin "A"
Viola M Griblin "B"
Comp 3-26-22
Dry Hole T.D 1820
Comp 9-1-26
Sand 1780-1823'
T.D 1823
I.P. 5 bbls.
Comp 5-22-24
Sand 1766-1777
I.P. 15 bbls
Comp 1-1-21
Sand 1767-1786
I.P. 25 bbls
Comp 7-10-25
Sand 1802-1807
I.P. 5 bbls
Comp 1-15-22
Dry Hole
T.D. 1795'
Comp 7-22-21
Sand 1703-1734
T.D. 1734
I.P. 20 bbls.
Comp 2-18-22
Sand 1786-1830
T.D. 1830
I.P. 24 bbls.
Comp 8-6-24
Sand 1770-1783
I.P. 40 bbls
Comp 8-20-23
Sand 1772-1781
I.P. 15 bbls
Comp 4-19-22
Sand 1745-1763
I.P. 4 bbls Oil
Comp 3-1-25
Sand 1783-1791
I.P. 13 bbls.
Comp 4-19-22
Sand 1724-1738
I.P. 10 bbls.
Comp 2-4-22
Sand 1707-1738
I.P. 40 bbls
Comp 6-10-23
Sand 1763-1785
I.P. 30 bbls
Comp 3-26-22
Sand 1701-1713
I.P. 25 bbls
Comp 6-5-24
Sand 1765-1781
I.P. 15 bbls.
1738'
Comp 5-21-22
Dry Hole
2495'
Comp 7-23-24
Sand 1519-1784
T.D. 1784
I.P. 150 bbls
780
820
1320
C N

16

15

Mid-Continent Petroleum Corporation

Comp 3-26-22
Dry Hole T.D 1820

Comp 9-1-26
Sand 1790-1833
T.D 1833
I.P 5 bbls

Florence Oil Co.

Comp 1-15-22
Dry Hole
T.D 1795

Comp 7-22-21
Sand 1705-1734
T.D 1734
I.P 20 bbls.

Comp 11-7-21

Comp 1-18-22

Phillip Sauder

Comp 7-23-26
Sand 1519-1594
T.D 1594
I.P. 130 bbls.

Comp 11-3-23
Sand 1525-1566
I.P 100 bbls

Comp 6-10-23
Sand 1512-1617
I.P 100 bbls

Mid-Continent Petroleum Corporation

Q. M. Shadel

Comp 6-20-23
Sand 1732-1781
I.P 15 bbls

Comp 4-19-22
Sand 1745-1769
I.P 4 bbls Oil
2 Water

Comp 2-18-22
Sand 1826-1830
T.D 1875
I.P 25 bbls.

Comp 4-19-22
Sand 1724-1738
I.P 10 bbls.

Comp 2-4-22
Sand 1707-1738
I.P 40 bbls

Comp 6-20-23
Sand 1763-1785
I.P 30 bbls

Comp 3-26-22
Sand 1701-1719
I.P 25 bbls

Comp 4-9-24
Sand 1765-1781
I.P 15 bbls.

1738'

Comp 5-21-22
Dry Hole

Mid-Continent Petroleum Corporation

Mid-Continent Petroleum Corporation

Comp 4-20-22
Dry Hole

2495'

Viola M. Griblin "A"

Viola M. Griblin "B"

C. N. Shambaugh "B"

21

22

LEGEND

[fols. 68 & 69] Defendant's Exhibits

DEFENDANT'S EXHIBIT A is as follows:

Arkansas City, Kansas, May 30, 1932.

Mid Continent Petroleum Corp., Tulsa, Okla. c/o Mr. Wills.

DEAR SIR: Herewith find list of wells of the Howell-Shaffer Oil Company. The production of oil and water (daily) also the different formation they are producing from.

Well	Oil Bbls.	Water Bbls.	Formation
1	3	2	Lime
2	5	3	Lime
3	2	4	Lime
4	3	380	Sand
5	2	2	Lime
6	1	3	Sand
7	1	1	Lime
8	6	40	Sand
9	3	60	Sand
10	5	75	Sand
11	3	5	Lime
12	10	80	Sand
13	10	70	Sand
14	3	60	Sand
15	2	4	Lime

Yours truly, Lloyd Snyder.

DEFENDANT'S EXHIBIT B is as follows:

Arkansas City, Kansas, May 26, 1932.

Mid-Continent Petroleum Corp., Tulsa, Oklahoma.

Attention: Mr. Wills

DEAR SIR: Confirming our verbal conversation—herewith find a list of the present production of oil and water on some of our leases adjoining the Phillip Souder lease:

[fol. 70]

Q. M. Shadel	Well	# 1	1 bbl.	Oil	2 bbl.	Water	
	"	# 2	5 bbl.	"	45 "	"	
	"	# 3	10 "	"	40 "	"	
	"	# 4	3 "	"	5 "	"	
	"	# 5	10 "	"	35 "	"	
	"	# 6	5 "	"	100 "	"	
	"	# 7	20 "	"	35 "	"	
	"	# 8	6 "	"	45 "	"	
	"	# 9	Abandoned		Dry hole		
	"	#10	10 "	"	40 "	"	

The production on the Phillip Souder lease is as follows:

Well	# 1	4 bbl.	Oil	6 bbl.	Water	
"	# 2	3 "	"	6 "	"	

The Florence Oil Co., directly West of the Phillips Souder wells produce as follows:

Well	# 1	4 bbl.	Oil	25 bbl.	Water	
"	# 3	4 "	"	50 "	"	

Our 2 offset wells to the Phillip Souder lease on the south

#2	makes	10 bbl.	Oil	15 bbl.	Water	
#4	"	3 "	"	10 "	"	

We will have a prepared list in a few days of the production and sand records of the Howell and Shaffer property which adjoins this Souder lease on the east and north of our Shadel lease.

Yours truly, Lloyd Snyder.

DEFENDANT'S EXHIBIT C is as follows:

Arkansas City, Kansas, June 1, 1932.

Mid-Continent Petroleum Corp., Tulsa, Oklahoma.

Attention: Mr. Wills

DEAR SIR: Herewith find a list of the wells on the East ½ of sec. 10-22-13 on the T. F. Schneider lease of the Theta Oil Co., in Greenwood County, Kansas:

[fols. 71 & 72]

	Oil	Water	Formation
Well # 1	Abandoned		
" # 2	3 bbl.	1 bbl.	Lime
" # 3	1 "	10 "	Sand
" # 4	2 "	½ "	Lime
" # 5	3 "	No	Lime
" # 6	Abandoned		
" # 7	2 "	5 "	Lime
" # 8	2 "	3 "	Sand
" # 9	Abandoned		
" #10	"		
" #11	"		
" #12	4 bbl.	No	Sand
" #13	3 "	9 "	Lime
" #14	1 "	40 "	Lime
" #15	5 "	5 "	Sand
" #16	3 "	2 "	Sand
" #17	15 "	No	Lime
" #18	5 "	5 "	Lime
" #19	1 "	5 "	Lime
" #20	5 "	1 "	Lime
" #21	Abandoned		
" #22	2 "	5 "	Sand
" #23	3 "	3 "	Sand
" #24	2 "	20 "	Sand
" #25	Drilling		

Yours truly, Lloyd Snyder.

Defendant's Exhibit D was a plat or map showing the location of the wells drilled on the property adjoining the involved lease, and which were producing from the Bartlesville Sand, showing the depths at which the sand was encountered and, in some instances, the thickness of the sand, which map or plat is as follows:

(Here follows Exhibit D, side folio 73)

BARTLESVILLE SAND

T.WP.23 S R.13 E

DEFT'S. EX.
NO. D
W.L.B.

13

5 3 2

8 9 10 11

17

15

14

20

21

22

23

[fols. 74-76] Defendant's Exhibit E was a map or plat showing the location of the wells on the involved lease and property adjoining the said lease, which were producing from the Lime, and shows the contour of the Mississippi Lime and the depths at which production was encountered in said lime, which map or plat is as follows: .

(Here follows Exhibit E, side folio 77)

Greenwood Co

T W P. 23 S R. 13 E

Coffey C

6 5 4 3 2

7 8 9 10 11

18 17 16 15 14

Greenwood Co

TWP. 23 S R. 13 E

Coffey Co

72A
77

Top Mississippi Lime

Top Mississippi Lime

[fols. 78 & 79] The above and foregoing is all of the evidence introduced at the trial of said case and is all proceedings in the trial thereof.

Wherefore, the Mid-Continent Petroleum Corporation, defendant and appellant, prays that the above statement of the evidence be settled, approved and allowed by the above entitled court as a true, full, correct and complete statement of all the evidence introduced at the trial of said cause, and all proceedings had at said trial, for use on the appeal taken to the United States Circuit Court of Appeals for the Tenth Circuit.

Dated the 25th day of October, 1932.

R. H. Wills, Douglas Hudson, Attorneys for Defendant and Appellant.

Service of the foregoing proposed statement of the evidence and receipt of a copy thereof this 27th day of October, 1932, is hereby admitted and acknowledged.

W. L. Huggins, Ray S. Pierson, Attorney- for Plaintiffs and Appellees.

STIPULATION RE STATEMENT OF EVIDENCE

It is hereby stipulated that the above and foregoing statement of the evidence is true and correct and may be approved by the Judge without notice.

W. L. Huggins, Ray S. Pierson, Attorney- for Plaintiffs and Appellee-. R. H. Wills, Douglas Hudson, Attorneys for Defendant and Appellant.

ORDER SETTLING STATEMENT OF EVIDENCE

The foregoing statement of evidence is in all respects hereby approved and settled as a true and complete statement of the evidence adduced and all proceedings had on the trial of the above entitled action.

Dated this 2nd day of November, 1932.

Richard J. Hopkins, United States District Judge.

[File endorsement omitted.]

[fol. 80] IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL—Filed Oct. 21, 1932

The above named defendant, Mid-Continent Petroleum Corporation, considering itself aggrieved by the decrees made and entered in the above entitled cause on the 14th day of September, 1932, and on the 7th day of October, 1932, does hereby appeal from said decrees to the United States Circuit Court of Appeals for the Tenth Circuit for the reason specified in the Assignment of Errors which is filed herewith, and it prays that this appeal be allowed and that a *citizen* be issued as provided by law, and that a transcript of the record, proceedings and papers upon which said decrees were made, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Tenth Circuit under the rules of such court in such cases made and provided.

J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewitz, J. P. Greve, Douglas Hudson, Attorneys for Defendant.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

ASSIGNMENT OF ERRORS—Filed Oct. 21, 1932

Comes now the Mid-Continent Petroleum Corporation, a corporation, defendant in the above entitled cause, and files the following assignment of errors upon which it will rely in the prosecution of its appeal in the above entitled cause from the decrees made by this Honorable court on the 14th day of September, 1932, and on the 7th day of October, 1932:

1. That while said court filed herein a Memorandum Decision containing certain findings of fact and conclusions of law, said court failed to make findings of fact and conclusions of law in the manner and form required by Equity Rule 70½, and said court erred in not making such findings of fact and conclusions of law.

2. That the court erred in finding in its Memorandum Decision that there was, in its opinion, some probability

that damage was being done to the leasehold estate involved herein by draining, through wells upon adjoining proper-
[fol. 81] ties, for the reason that there was no evidence to support such findings, and said finding is contrary to all the evidence.

3. That the court erred in finding in said Memorandum Decision that there was no positive evidence introduced by either party as to the contention of the plaintiffs that there was a well defined trend of oil producing sand and lime running in a southwesterly northeasterly direction over and across the land involved herein, and that nothing but exploration and positive tests by drilling on said land could settle the controversy as to whether oil and gas in paying quantities could be found under said land, for the reason that the defendant did introduce a vast amount of evidence to the effect that there was no sand or lime under said land from which oil or gas in addition to that which was being produced by the defendant could be produced and that there was no likelihood that additional oil or gas could be produced from said land, and there was no evidence to the contrary.

4. That the court erred in finding in said Memorandum Decision that on June 16th, 1926, or any other date, Phillip Sauder made demand upon the defendant, or any of its predecessors in title, to drill any additional well or wells upon the land involved herein, for the reason that there was no evidence to support such finding, and the same is contrary to the evidence.

5. That the court erred in finding in said Memorandum Decision that the defendant had "no intention to further develop said lease unless and until further developments in the immediate vicinity thereof might convince said defendant and its officers that it would pay the defendant to further explore or develop said lease," for the reason that there was no evidence to support such finding, and the same is contrary to the evidence.

6. That the court erred in finding in said Memorandum Decision that "the evidence offered by the defendant indicates no intention to further develop," for the reason that there is no evidence to support such finding, and the same is contrary to the evidence.

7. That the court erred in finding in said Memorandum Decision that the defendant had not in good faith explored and developed the lease involved herein, for the reason that [fol. 82] there was no evidence to support such finding, and the same is contrary to the evidence.

8. That the court erred in finding in said Memorandum Decision that the defendant had not shown diligence in exploring and developing the land involved herein as was required under the law, equity and good conscience, for the reason that there was no evidence to support such finding, and the same is contrary to the evidence.

9. That the court erred in its finding in said Memorandum Decision which reads as follows: "The court finds each and all of the other issues of fact involved herein in favor of the plaintiffs and against the defendant," for the reason that such finding is not in accordance with, nor in the manner and form required by, Equity Rule 70½, and for the further reason that there was no evidence to support such finding, and the same is contrary to the evidence.

10. That the court erred in concluding, as a matter of law, in said Memorandum Decision that the defendant and its predecessors in title had not in good faith and with reasonable diligence explored and developed the lands involved herein in accordance with the express and implied covenants of the lease involved herein, for the reason that there was no evidence to support such conclusion, and the same is contrary to the evidence and contrary to the law.

11. That the court erred in concluding, as a matter of law, in said Memorandum Decision, that "it would be inequitable and unjust to permit the defendant to hold, keep and retain the leasehold property involved herein, without further exploration and development as said defendant proposed to do, as shown in the pleadings and evidence herein," for the reason that there was no evidence to support such conclusion, and the same is contrary to the evidence and contrary to the law.

12. That the court erred in concluding, as a matter of law, in said Memorandum Decision "that the plaintiffs, under the evidence, are entitled to a judgment of this court cancelling said lease as to all the land described therein, except the Southwest Quarter (SW¼) of the Southeast

Quarter (SE¼) of the Southwest Quarter (SW¼) of said Section Sixteen (16), upon which the two aforesaid wells heretofore mentioned were drilled and developed by defend- [fol. 83] ant, or its predecessors in title," for the reason that there was no evidence to supoprt such conclusion, and the same is contrary to the evidence and contrary to the law.

13. That the court erred in concluding, as a matter of law, in said Memorandum Decision that the defendant was only entitled to hold and enjoy its leasehold rights upon the Southwest Quarter (SW¼) of the Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of said Section Sixteen (16), so long as it produces oil or gas therefrom in paying quantities, for the reason that there was no evidence to support such conclusion, and the same is contrary to the evidence and contrary to the law.

14. That the court erred in its conclusion of law in said Memorandum Decision which reads as follows: "I find each and all the other issues of law involved herein in favor of the plaintiffs and against the defendant," for the reason that such conclusion is not in accordance with, nor in the manner and form required by Equity Rule 70½, and for the further reason that there was no evidence to support such Conclusion, and the same is contrary to the evidence and contrary to the law.

15. That the court erred in not finding each and all of the Findings of Fact requested by the defendant, for the reason that each and all of said Requested Findings were in accordance with the evidence, and there was no evidence to the contrary.

16. That the court erred in not finding, as requested by the defendant, that none of the oil wells in the vicinity of the land involved herein drained, or is draining, or is likely to drain any oil or gas from underneath the surface of the land involved herein, for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

17. That the court erred in not finding as requested by the defendant, that none of the wells upon any of the land adjoining the land involved herein was an offset well, save and except the certain wells which offset the two wells upon

the land involved herein, for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

18. That the court erred in not finding, as requested by [fol. 84] the defendant, that the defendant and those from and under whom it claimed had diligently operated and developed the land involved herein for oil and gas purposes, and fully and completely performed all of their express and implied obligations under and by virtue of the oil and gas mining lease involved herein, for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

19. That the court erred in not finding, as requested by the defendant, that the defendant and its predecessors in title had drilled as many wells upon the land involved herein as could be reasonably expected of an oil and gas operator of ordinary prudence, and that no oil and gas operator of ordinary prudence would have drilled any additional well or wells upon said land for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

20. That the court erred in not finding, as requested by the defendant, that neither the defendant nor any of those from and under whom it claimed, had abandoned any part of the oil and gas mining lease involved herein or any part of the premises covered thereby, for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

21. That the court erred in not finding, as requested by the defendant, that prior to the commencement of this action neither Phillip Sauder, nor any of the plaintiffs, or any of them, made any demand or demands upon the defendant, or any of its predecessors in title, to drill any well or wells upon the land involved herein, in addition to the two wells drilled thereon, or to further develop said land for oil and gas, for the reason that such Requested Finding was in accordance with the evidence, and there was no evidence to the contrary.

22. That the court erred in not concluding, as a matter of law, as requested by the defendant, that the defendant was the absolute owner and holder of the oil and gas mining

lease involved herein, and that said oil and gas mining lease was a good, valid and subsisting oil and gas mining lease and was in full force and effect as to each and every part of the 360 acres of land covered thereby, and that said [fol. 85] defendant was entitled to the possession of said 360 acres of land, and each and every part thereof, under and by virtue of said lease and for the purposes thereof, for the reason that such Requested Conclusion was in accordance with the evidence, and there was no evidence to the contrary.

23. That the court erred in not concluding, as a matter of law, as requested by the defendant, that the plaintiffs were not entitled to the cancellation of the oil and gas mining lease involved herein, or any part thereof, or insofar as the same covered any portion of the 360 acres of land involved herein, for the reason that such Requested Conclusion was in accordance with the evidence, and there was no evidence to the contrary.

24. That the court erred in not concluding, as a matter of law, as requested by the defendant, that the evidence was wholly insufficient to entitled the plaintiffs to any judgment whatsoever against the defendant, and that the defendant was entitled to judgment herein, for the reason that such Requested Conclusion was in accordance with the evidence, and there was no evidence to the contrary.

25. That the court erred in overruling the defendant's demurrer to the plaintiffs' evidence, for the reason that said evidence was wholly insufficient to establish a cause of action in favor of the plaintiffs, or any of them, and against the defendant, or to entitle the plaintiffs, or any of them, to any relief whatsoever in equity.

26. That the court erred in not rendering judgment against the plaintiffs, and each of them, and in favor of the defendant, dismissing the plaintiffs' petition and the above entitled cause for want of equity.

27. That the court erred in its final decree made and entered on the 14th day of September, 1932, in cancelling, setting aside and holding for naught the oil and gas lease involved herein, save and except as to that part of the Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of Section 16, Township 23, Range 13, in Greenwood County,

Kansas, described as follows: Beginning at the Southwest corner of the aforesaid SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence East 860 feet along the South line of said SE¼ of the SW¼, thence north 400 feet, thence West 860 feet to the West line of said SE¼ of the [fol. 86] SW¼, thence South along said West line 400 feet to the point of beginning, for the reason that neither the evidence nor the facts found by the court was or were sufficient to justify the same, and that the same was contrary to the evidence and the facts found by the court and also contrary to the law.

28. That the court erred in its final decree made and entered herein, on the 7th day of October, 1932, in cancelling, setting aside and holding for naught the oil and gas lease involved herein, save and except as to that part of the Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of Section 16, Township 23, Range 13, in Greenwood County, Kansas, described as follows: Beginning at the Southwest corner of the aforesaid SE¼ of the SW¼ of Section 16, Township 23, Range 13, thence 860 feet along the South line of said SE¼ of the SW¼, thence North 400 feet, thence West 860 feet to the West line of said SE¼ of the SW¼, thence South along said West line 400 feet to the point of beginning, for the reason that neither the evidence nor the facts found by the court was or were sufficient to justify the same, and that the same was contrary to the evidence and the facts found by the court and also contrary to the law.

29. That the final decree of the court made and entered herein on the 14th day of September, 1932, is not supported by and is contrary to the evidence herein.

30. That the final decree of the court made and entered herein on the 7th day of October, 1932, is not supported by and is contrary to the evidence herein.

31. That the final decree of the court made and entered herein on the 14th day of September, 1932, is contrary to the law.

32. That the final decree of the court made and entered herein on the 7th day of October, 1932, is contrary to the law.

33. That the final decree of the court made and entered herein on the 14th day of September, 1932, is not supported by and is contrary to the facts found by the court herein.

34. That the final decree of the court made and entered herein on the 7th day of October, 1932, is not supported by and is contrary to the facts found by the court herein.

[fol. 87] Wherefore, the defendant, Mid-Continent Petroleum Corporation, prays that said decrees may be reversed, and that said United States District Court for the District of Kansas, Third Division, be ordered to enter a decree reversing its final decrees herein, and upon this appeal complained of, and to make, enter and render a decree dismissing the above entitled cause and the plaintiffs' petition therein for want of equity, and such other and further relief as may be just and equitable.

J. C. Denton, J. H. Crocker, R. H. Wills, I. L. Lockewitz, J. P. Greve, Douglas Hudson, Attorneys for Defendant, Mid-Continent Petroleum Corporation.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING APPEAL—Filed Oct. 21, 1932

The petition of the Mid-Continent Petroleum Corporation, defendant in the above entitled cause, for an appeal from the final decrees entered therein on the 14th day of September, 1932, and on the 7th day of October, 1932, is hereby granted and the appeal is allowed, and, upon the petitioner filing a bond in the sum of Three Thousand Dollars ($3,000.00) with sufficient sureties and conditioned as required by law, the same shall operate as a supersedeas of the decrees made and entered in the above entitled cause and shall stay and suspend all future proceedings in this court until the termination of said appeal by the United States Circuit Court of Appeals for the Tenth Circuit.

Dated this 21st day of October, 1932.

Geo. T. McDermott, Circuit Judge.

[File endorsement omitted.]

[fol. 88] RECITAL AS TO BOND

Supersedeas and cost bond in the sum of $3,000, approved by Geo. T. McDermott, Circuit Judge, with appellant as principal and New Amsterdam Casualty Company as surety, was filed in the District Court on Oct. 21, 1932.

IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed Oct. 27, 1932

The plaintiffs in the above entitled cause are hereby notified that the defendant herein appeals from the decrees of the court as entered on the 14th day of September, 1932, and on the 7th day of October, 1932. Said appeal will be to the United States Circuit Court of Appeals for the Tenth Circuit, in accordance with the citation as issued in this cause on the 21st day of October, 1932.

J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewifz, J. P. Greve, Douglas Hudson, Attorneys for Defendant.

Service of the above Notice of Appeal accepted this 25th day of October, 1932.

W. L. Huggins, Ray S. Pierson, Attorneys for Plaintiffs.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed Nov. 1, 1932

To the Clerk of the above entitled court:

You are hereby requested to make a printed transcript of the record to be filed in the United States Circuit Court of Appeals for the Tenth Circuit, pursuant to an appeal allowed in the above entitled cause, and to include in said transcript of the record the following, and no other papers and exhibits, to-wit:

1. Petition filed in the State Court.
2. Petition for Removal.
3. Notice of Petition and Bond for Removal.

[fol. 89] 4. Bond on Removal.

5. Order of Removal.
6. Order Reviving Action.
7. Amended Petition of Plaintiffs.
8. Answer of Defendant.
9. Defendant's Requested Findings of Fact and Conclusions of Law.
10. Plaintiffs' Requested Findings of Fact and Conclusions of Law.
11. Memorandum Decision of the court.
12. Decree of September 14, 1932.
13. Decree of October 7, 1932.
14. Narrative Statement of the Evidence.
15. Petition for Appeal.
16. Order Allowing Appeal.
17. Assignment of Errors.
18. Citation, with service.
19. Supersedeas and Appeal Bond.
20. This Præcipe.

Said transcript to be prepared as required by law and the rules of this court and the rules of the United States Circuit Court of Appeals for the Tenth Circuit, and to be filed in the office of the Clerk of the United States Circuit Court of Appeals for the Tenth Circuit at Denver, Colorado, on or before the 29th day of November, 1932.

Dated this 25th day of October, 1932.

J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewitz, J. P. Greve, Douglas Hudson, Attorneys for Appellant.

[fol. 90] Service of the above Præcipe accepted and acknowledged this 27th day of October, 1932.

W. L. Huggins, Ray S. Pierson, Attorneys for Appellees.

It is hereby stipulated and agreed by and between the attorneys for the respective parties herein that the above and foregoing shall constitute the entire record on appeal in the above entitled cause.

Dated this 25th day of October, 1932.

J. C. Denton, R. H. Wills, J. H. Crocker, I. L. Lockewitz, J. P. Greve, Douglas Hudson, Attorneys for Appellant. W. L. Huggins, Ray S. Pierson, Attorneys for Appellee.

[File endorsement omitted.]

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 91] Minute entry of argument and submission, June 9, 1933, omitted in printing.

IN UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT, SEPTEMBER TERM, 1933

No. 773

R. H. Wills (J. C. Denton, J. H. Crocker, I. L. Lockewitz and J. P. Greve were with him on the brief) for appellant.
W. L. Huggins and Ray S. Pierson for appellees.

Before Phillips and McDermott, Circuit Judges, and Kennedy, District Judge

OPINION—September 14, 1933

PHILLIPS, Circuit Judge, delivered the opinion of the court:

Philip Sauder brought this suit against the Mid-Continent Petroleum Corporation seeking the cancellation of an oil and gas lease covering the east half, and the southeast quarter of the southwest quarter, Sec. 16, Twp. 23 South, Range 13, Greenwood County, Kansas, as to the undeveloped portion thereof. We shall refer to the land just described as the Sauder lease. During the pendency of the cause, Philip Sauder died, and it was revived in the names of appellees herein, who are all his heirs at law.

The lease was entered into June 6, 1916, and ran from Philip Sauder to Annie Sauder, his wife, to W. A. Moon and J. W. Phillips. It passed through mesne assignments to the Petroleum Corporation. It contained the following provision:

[fol. 92] "That the said parties of the first part * * * do hereby Lease and Let unto the said parties of the second part the exclusive right for Ten Years from date hereof, and as long thereafter as Oil or Gas can be procured thereon in paying quantities, to enter upon, operate for

and procure Oil and Gas upon the following described premises. * * *"

During the primary term of the lease, the predecessors in title to the Petroleum Corporation completed two wells on the southeast quarter of the southwest quarter of Sec. 16. The first well was completed November 1, 1921, and the second January 1, 1922. There has been no further drilling on the Sauder lease.

The only evidence introduced by the appellees was a map showing producing wells situated east of the Sauder lease in Sections 10, 15 and 22, and south and west thereof in Sections 17, 20 and 21. The producing wells nearest to the Sauder lease were: One situated 660 feet east of the east line, one 200 feet west of the west line, and two 200 feet south of the south line. The last mentioned wells were offset by the two wells drilled on the Sauder lease. The wells to the east of the Sauder lease were producing from the Bartlesville sand, and those to the south and west from the Mississippi lime.

The uncontroverted evidence on the part of the Petroleum Corporation established these facts:

The total revenue from the two wells drilled by the predecessors of the Petroleum Corporation, up to December 31, 1931, was $83,079, of which it received seven-eighths, and the Sauders one-eighth as royalty. Up to December 31, 1931, the Sauder lease had yielded to the Petroleum Corporation 5.1% per annum on the cost of the present development.

The Bartlesville sand in the vicinity of the Sauder lease is found in long narrow strips averaging about three well locations in width. The wells are located a distance of about 460 feet apart, and not nearer than 200 feet to the lease lines. The producing area of the strip of Bartlesville sand here involved has been well defined by drilling. Dry holes have been drilled between this producing area and the east line of Sauder lease. Wells along the west edge of the producing area have produced more water and less oil than the wells farther east. The sand along such edge is thinner and is found at greater depths than at [fol. 93] points farther east. Wells drilled north, south, and west of the Sauder lease encountered no production in

the Bartlesville sand. These facts demonstrate that such producing area lies to the east of the Sauder lease.

The wells on the Sauder lease and those to the south and west thereof are producing from the Mississippi lime. The Mississippi lime produces oil at its higher points and is barren of oil at its lower points, that is, the oil is found where the lime is nearer to the surface. The two wells drilled on the Sauder lease, and the wells drilled to the north, west, and south thereof indicate that the lime on this lease dips sharply in every direction toward the Sauder lease, except from the northwest to the southeast, and that the lime is so low on the Sauder lease that probably no oil will be found therein in paying quantities except in the southeast quarter of the southwest quarter. The geologist for the Petroleum Corporation estimated the lime on the undeveloped portion of the Sauder lease to lie at a depth of from 580 to 610 feet below sea level. The wells that encountered the lime at a greater depth than 570 feet below sea level in the vicinity of the Sauder lease, were usually dry holes or produced oil in negligible quantities.

Absence of oil in paying quantities in the Mississippi lime on the Sauder lease is indicated also by the following facts: Four dry holes were drilled near such lease, one in the southeast quarter of Sec. 9, 1880 feet north of the north line and 200 feet west of the east line of the lease, one in the northwest quarter of Sec. 16, 630 feet west of the west line of the lease and 290 feet north of the center of Sec. 16, and one in the southwest quarter of the southwest quarter of Sec. 16, 200 feet west of the west line and 1000 feet north of the south line of the lease. A well in the southwest quarter of section 15, 760 feet east of the east line of the lease, and a well in the northwest quarter of that section were drilled to, and failed to encounter oil in paying quantities in the Mississippi lime. The westerly well drilled on the Sauder lease encountered a thicker lime than the one to the east. The former produced 75 barrels of oil per day, while the production from the latter was slight. The former reached the lime at 558 feet, and the latter reached the lime at 574 feet below sea level.

[fol. 94] Mr. Moody, vice-president of the Petroleum Corporation in charge of production of oil and gas, testified that the geological information indicated that oil and gas

would not be found in paying quantities on the undeveloped portion of the Sauder lease; that such was the opinion of the representatives of the Petroleum Corporation; that if future development or additional geological information should indicate that their opinion was wrong, they would be willing to drill additional wells on such lease; that they had not abandoned such lease, and it was their intention to hold it under the terms of the lease for future development.

The trial court canceled the lease, except as to a small tract in the southeast quarter of the southwest quarter of Sec. 16, surrounding the two producing wells.

In Denker v. Mid-Continent Petr. Corp. (C. C. A. 10) 56 F. (2d) 725, this court said:

"In order to comply with the implied covenants of a lease to drill offset wells and to diligently develop the lease, a lessee must do that which, under the circumstances, an operator of ordinary prudence, having regard to the interests of both lessor and lessee, would do. Brewster v. Lanyon Zinc Co. (C. C. A. 8), 140 F. 801; Pelham Petroleum Co. v. North, 78 Okl. 39, 188 P. 1069, 1072; Goodwin v. Standard Oil Co. (C. C. A. 8) 290 F. 92; Humphreys Oil Co. v. Tatum (C. C. A. 5) 26 F. (2d) 882; Orr v. Comar Oil Co. (C. C. A. 10) 46 F. (2d) 59, 63; 40 C. J. p. 1067, Sec. 684."

This is the rule announced by the great weight of authority. It has been approved by the Kansas decisions. See Webb v. Croft, 120 Kas. 554, 244 Pac. 1033; Howerton v. Kans. Nat. Gas Co., 81 Kas. 553, 106 Pac. 47; Id. 82 Kas. 367, 108 Pac. 813; Day v. Kansas City Pipe Line Co., 82 Kas. 861, 109 Pac. 186.

It has been recently followed in Broswood O. & G. Co. v. Mary O. & G. Co.,—Okl.—, 23 P. (2d) 387, where the court, under a state of facts similar to those in the instant case, refused to cancel the undeveloped portion of an oil and gas lease.

In Webb v. Croft, supra, decided April 10, 1926, the court said:

[fol. 95] "The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable develop-

ment of the land by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling."

However, in McCarney v. Freel, 121 Kas. 189, 246 Pac. 500, decided June 12, 1926, after the lease here involved was entered into, the court stated the facts as follows:

"The lease was dated June 15, 1912, and embraced a quarter section of land. The term was for 10 years, and as much longer as oil or gas could be produced in paying quantities. In October, 1912, a well was drilled which produced and still produces oil in paying quantities. In November, 1917, a dry hole was drilled. No further effort has been made to develop the oil and gas resources of the land, although numbers of producing wells have been drilled and are in operation on all the surrounding land. *Plaintiff's evidence warranted the inference that defendants have not reasonably developed her land, and have no present intention to do so.*" (Italics ours.)

And then said:

"A lease may not hold an entire quarter section of land with a single producing well after expiration of term, any more than he may do so before expiration of term. The implied covenant, fairly to exhaust capability of the land to produce mineral, subsists. If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas be produced in paying quantities."

There must be ground for the cancellation of an oil and gas lease. In the absence of fraud or mistake, there must be a substantial breach of an express or implied covenant of the lease. The burden of proof to establish such a breach was upon the appellees. Goodwin v. Standard Oil Co. (C. C. A. 8) 290 Fed. 92, 98. With respect to development, there is an implied obligation on the part of a lessee to drill [fol. 96] such wells as under the circumstances an operator of ordinary prudence, having regard for the interests of

both the lessor and lessee, would drill. The trial court did not find that the Petroleum Corporation had breached such implied obligation. Indeed, such a finding would have been wholly without support in the evidence.

The trial court's decision in the instant case was predicated on the doctrine announced in McCarney v. Freel, supra. The supreme court in that case said the evidence justified the inference that there was a breach of the covenant to develop. The decree was predicated on that breach. Here, as before stated, there was no breach of any covenant to develop, express or implied. We think it is distinguishable from the instant case.

If the doctrine announced in McCarney v. Freel, supra, is to be applied broadly to a state of facts such as exist in the instant case, it amounts to this: That where, under the existing circumstances and the known geological information, an operator of ordinary prudence having regard to the interests of both lessor and lessee would not drill on a portion of the lease, notwithstanding the provision of the lease that it shall extend to the whole tract as long as oil or gas is produced therefrom in paying quantities, the lessee by failing to drill on such portion forfeits his lease as to that portion. In other words, he must either do that which a prudent operator would not do or forfeit a portion of his lease. The implied covenant to develop imposes no such burden.

Since McCarney v. Freel, supra, was decided long after the date this lease was entered into, while persuasive, it is not binding on us. Kuhn v. Fairmont Coal Co., 215 U. S. 349; Denker v. Mid-Continent Petr. Corp. (C. C. A. 10) 56 F. (2d) 725, 727. It is true that in Day v. Kansas City Pipe Line Co., 87 Kas. 617, 125 Pac. 43, decided July 6, 1912, the Kansas court uttered a dictum which supports McCarney v. Freel, supra. But in the lease there involved, there was an express covenant to "continue drilling as long as paying wells were found or royalties were paid," and there was an express finding that the lessee had not diligently developed the leased premises. It is clearly distinguishable from the instant case, because here there was no breach of the implied covenant to develop, and there is no express covenant in the lease to continue drilling as long [fol. 97] as paying wells are found or royalties are paid.

We are unable to subscribe to the doctrine of McCarney

v. Freel, supra, as construed by the trial court, because in our opinion it either imposes a greater obligation under the implied covenant to develop than is recognized by the great weight of authority, including many Kansas decisions, or it places an obligation on the lessee not imposed by the lease contract, and in effect makes a new contract for the parties.

With much geological information at hand strongly indicating an absence of oil and gas in paying quantities in the undeveloped portion of the Sauder lease, we think it cannot be said that the Petroleum Corporation has done other than what a prudent operator, under the existing circumstances, having regard for the interests of both lessor and lessee, would have done. In view of the long lapse of time since any development has taken place on the lease, the large area undeveloped, and the fact that the lessor is precluded from exploring it himself or through a third person, slight indication that the undeveloped portion contains oil or gas in paying quantities, regard for the interests of the lessee as wall as the lessor, would require further development. But, under the facts as th-y existed hen this suit was tried, we are of the opinion that the etroleum Corporation had violated none of the express or implied covenants of the lease contract. Until it has, or the lease has expired by its terms, it is entitled to continue to hold the whole of the Sauder lease.

The costs will be assessed against appellees and the decree Reversed without prejudice to the bringing of a new suit, in the event changed conditions should indicate a breach of the implied covenant to develop.

Dissenting Opinion

McDermott, Circuit Judge, dissenting:

There are two reasons which lead me to the conclusion that the decree of the trial court should be modified to require the defendant either to drill a well within a reasonable time or surrender the unexplored 320-acre tract.

I

An oil and gas lease in Kansas conveys an interest in real estate. Robinson v. Smalley, 102 Kan. 842. The [fol. 98] rights of a holder of an oil and gas lease are

governed by the decisions of the state court. "These decisions constitute rules of property and must be accepted and applied in passing upon the complainant's rights." Guffey v. Smith, 237 U. S. 101, 113. Unless there is a commanding reason to the contrary, a non-resident should not be permitted to acquire a greater interest in Kansas real estate than a resident may acquire; nor should a sovereign state be denied the power to determine, within constitutional limits, the rights to real estate within its borders. Cities Service Oil Co. v. Roberts (C. C. A. 10) 62 F. (2d) 579.

To this settled rule there is a well recognized and proper exception. If an interest in real estate is acquired in reliance upon a rule of property then settled by state decisions, the federal courts will apply the law as laid down when the interest was acquired.

My understanding is that the genius of this exception lies in the reliance of the purchaser upon a rule of property law settled by the state decisions, and the injustice of denying to him the rights he believed he was acquiring. I do not understand that when a nonresident buys Kansas real estate he is not bound by any later decision of the Supreme Court of that state. A nonresident who sees fit to buy real property in another state ought to take his chances, along with residents, on how the Supreme Court of the state may eventually decide open questions.

Counsel for appellant state that McCarney v. Freel, 121 Kan. 189, "supports the conclusion of the trial court." It does. A lease on 160 acres was made in 1912. The original term had expired. The testimony for the defendant was that a lessee would not be justified in drilling more wells. In that case there was one producing well on 160 acres; in our case, two producers on 360 acres. That lease was less than 13 years old; the lease here was executed 17 years ago. The trial court there, as here, canceled the lease except as to a tract around the producing well. The Supreme Court of Kansas affirmed that decree.

It thus clearly appears that if the lessee of the Sauder lease were a resident of Kansas, the lessor would be entitled to relief. This nonresident lessee is not entitled to a greater right than a resident unless McCarney v. Freel is contrary to a rule of property established by the deci- [fol. 99] sions when the lease was made in 1916. An

examination of the decisions prior to 1916 persuades me that McCarney v. Freel did not overturn any settled rule of property law; but on the contrary finds support in the earlier decisions.

In Mills v. Hart, 77 Kan. 218, 220, 94 P. 142 (1908) the court laid down the general principles underlying mineral lease law as follows:

"The only consideration moving to the lessor for the right which he gave to the lessee to explore and procure minerals was the royalty on the coal to be found and the fixed compensation for each well when gas should be found and utilized, together with sufficient gas to supply two stoves in his farmhouse. If there were no search, nor any product, no possible benefit could come to the lessor for the exclusive rights which had been given to the lessee. It is not easy to infer that the lessor intended to give a valuable right for a nominal consideration, and permit the lessee to retain the right for a period of twenty years without development, when development was the chief purpose in the execution of the lease. Neither the character of the right given nor the nature of the instrument admits of such an irrational interpretation. The lease contemplates that the lessee shall proceed to dig and bore for gas, oil and coal, and that the lessor shall obtain gas for his farmhouse, not twenty years hence, but as soon as it can reasonably be procured."

In the case of Howerton v. Gas Company, 81 Kan. 553 (1910) the court cited and followed Brewster v. Lanyon Zinz Co. (C. C. A. 8) 140 F. 801, 809, 810, which is undoubtedly the leading case on the subject of implied covenants diligently to explore and develop. The primary term of the lease involved in the Brewster case had expired; there was one producing well thereon when the suit to cancel the lease was brought. Justice Van Devanter's entire opinion is illuminating, but the following excerpts are particularly pertinent:

"The implication necessarily arising from these provisions—the intention which they obviously reflect—is that if, at the end of the five-year period prescribed for original exploration and development, oil and gas, one or both, had been found to exist in the demised premises in paying quantities, the work of exploration, development, and produc-

[fol. 100] tion should proceed with reasonable diligence for the common benefit of the parties, or the premises be surrendered to the lessor. * * * The subject was, therefore, rationally left to the implication, necessarily arising in the absence of express stipulation, that the further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit. * * * Upon both principle and authority it must be held that the present lease contains a covenant by the lessee to continue, with reasonable diligence, the work of exploration, development, and production at the end of the five years, if during that time oil and gas, one or both, are found in paying quantities."

It will be noted that the implied obligation includes that of "exploration." The Supreme Court of Kansas, in the Howerton case, further indicated its conception of the duty of the lessee by the following quotation from the opinion of Justice Lurton in Petroleum Company v. Coal, Coke and Manufacturing Company, 89 Tenn. 381:

"The 'testing' provided for was manifestly a condition upon which the lease depended. If such test showed no minerals, then the contract was at an end; if it, on the other hand, showed the presence of valuable mines, then the lessees were bound to operate them in good faith for the joint profit of themselves and the owners of the fee."

Culbertson v. Cement Co., 87 Kan. 535 (1912) presents a different state of facts and the decision is not pertinent. The following statement of principle has some bearing:

"Since the number of wells to be drilled on the land was not specified there was an implied obligation on appellants to fully develop the land and put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas. Kleppner v. Lemon, 176 Pa. St. 502, 35 Atl. 109; Thornton, The Law Relating to Oil and Gas, §91."

In Day v. Pipe Line Co., 87 Kan. 617, 623 (1912) there were eight producing wells on two eighty-acre tracts in- [fol. 101] cluded in a single lease covering 600 acres. Al-

though the primary term had not expired, an action was brought to cancel the lease. Relief was granted as to the 440 acres upon which no wells had been drilled. There was an express covenant in that case, not present here, "to continue drilling as long as paying wells are found or royalties paid." The case is therefore distinguishable from the case at bar. The court interpreted the lease to require "that drilling should continue with reasonable diligence as long as paying wells could be found," and then held:

"The appellant was, of course, not required to develop land that had been tested and found to be unprofitable for operation, but if paying wells could not be found on the land or any part of it there is no reason why appellees' title should be longer clouded with a barren encumbrance nor any reason why appellant should resist a cancellation."

These decisions were all before the lease in question was executed. I think they do not conflict with those which follow; nor has the Kansas Supreme Court intimated, in any of the later cases, that there is any conflict between the earlier and later decisions.

Two years after this lease was given, the case of Alford v. Dennis, 102 Kan. 403, 405, (1918), was decided. In 1902 the lessor executed one lease covering two tracts, one of 220 acres and one of 716 acres. There were many producing wells on the larger tract, but no exploration of the smaller. The primary term had expired. The Supreme Court of Kansas held that it "was not the province of the court to end a contract merely because it is a bad bargain"; and that "The plaintiff asks the court to cancel this contract, to decree a forfeiture of it, and not for default of any expressed provision of the contract but merely for default of one of its implied covenants. The instances are rare where equity will enforce a forfeiture. It will never do so where less drastic redress will satisfy the demands of justice." Citing then its earlier decisions, the court said:

"Unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease, and as it stands it is of no value to defendants. Unless the defendants had a bona fide intention to prospect and de- [fol. 102] velop this tract they had no proper purpose in leasing it, and to cancel the lease will do them no injury.

While equity abhors forfeitures it likewise abhors injustice."

A decree was directed that the lease as to the 220-acre tract be canceled unless the lessee prospected and developed the tract within a reasonable time.

In Webb v. Croft, 120 Kan. 654, 657, 658 (1926) the primary term had expired. The lease covered 580 acres and there was one producing well thereon. The closest development to the lease were two wells, each three-fourths of a mile away. The facts were not as favorable to the lessor as the facts here. The trial court entered a decree requiring the lessee to develop or cancel. The Supreme Court affirmed and held, upon authority of its earlier decisions, that:

"Leases of this kind contemplate exploration and development and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both the lessor and lessee. Howerton v. Gas Co., 81 Kan. 553, 106 Pac. 47; Id., 82 Kan. 367, 108 Pac. 813; Alford v. Dennis, 102 Kan. 403, 170 Pac. 1005; Harris v. Ohio Oil Co., 57 Ohio St. 118. The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land by drilling such number of wells as an ordinarily prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling. * * * We think the court rightly concluded that the land of defendants has not been sufficiently developed. 'It would be grossly inequitable to hold a tract of 580 acres with no more development than has already been made. Plaintiff was entitled to some remedy for the failure to develop it, and we think it was competent for the Court, instead of decreeing a cancellation of the lease, to give the defendants an opportunity to make reasonable develop-
[fol. 103] ment of the land pursuant to their implied cove-

nants, as has already been determined in Alford v. Dennis, supra."

Then came McCarney v. Freel, squarely in point, and conceded by counsel to support the decree of the trial court.

There are other decisions of the Kansas court, but these appear to be sufficient to demonstrate that there has been no change in the current of Kansas authority from the start; and that either before or after 1916, that court would not permit a lessee to hold 320 acres for 17 years without exploration or development. As I read the decisions of the Kansas court, they adhere to the same general test first announced in Brewster v. Lanyon Zinc Co., supra, and followed by our court in Denker v. Mid-Continent Petroleum Corporation, 56 F. (2d) 725. The difference is that the Kansas court places more emphasis on the phrase "having due regard for the interests of the lessor" than does our court. The interpretation given to a general rule becomes a part of the rule, just as an interpretation of a statute becomes a part of the statute.

If I am right in this analysis of the Kansas decisions, Guffey v. Smith, supra, requires that Kansas law be applied. If I am wrong in my construction of the earlier Kansas decisions, the question was at least an open one except for the dictum in the Day case. Where the question is an open one at the time interests in real estate are acquired, the rights of the parties should be governed by the later decisions of the state court, and not by the still later decisions of the federal court. Why should the rights of these parties be determined by our decision in the Denker case decided in 1932, instead of the decision of the state Supreme Court in the McCarney case decided in 1926?

Forewarned by the earlier decisions and the dictum in the Day case that the Kansas Supreme Court would adhere to the rule that the principal consideration moving to a lessor was the development of his property, and that emphasis would be placed on the lessee's obligation to pay heed to the interest of the lessor, this nonresident came voluntarily to Kansas and acquired this lease. It does no more than to hold it to its bargain to say to it "When you buy Kansas real property, you hold it subject to Kansas law." Unless the McCarney case upset a rule of property law which was settled in 1916—and I can find no basis for [fol. 104] such a claim—there is no reason for according

this nonresident company rights in Kansas property which a resident company would not have acquired under the identical lease.

II

Even if the Kansas decisions are to be ignored, I come to the same conclusion. Since the decision in Brewster v. Lanyon Zinc Company, supra, the test laid down by both the state and federal courts is what a prudent operator, having regard for the interests of the lessor as well as his own, would do. If the phrase "having regard for the interests of the lessor" has any real meaning, I think the defendant ought not to hold 320 acres, almost surrounded by oil wells, without even one test well. The defendant, in common fairness, ought to give these lessors a well or get off and let some one else drill it.

Defendant's testimony is that the geologic inference is unfavorable. But geologic inference is not infallible. This is a spotted field, and its many dry holes give mute and expensive evidence of the fallibility of geology. Even Mr. Moody does not accord verity to his own geologists, for notwithstanding their unfavorable report, he is not willing to relinquish this half section. He frankly says that he wants to hold it because there may be oil under it. Of course that is true, or he would not go to the expense of defending this suit unless he thought enough of the possibilities to warrant the expense.

The truth is that this half section is neither proven nor condemned. No one will ever know whether there is oil under this land until a drill goes down. Mr. Moody says that; his geologists say it; their anxiety to keep it corroborates their statements. Mr. Moody wants some other company to drill on adjoining acreage; in other words, he wants to retain his gamble at the expense of his lessors and adjoining operators.

But geologic inference is not as unfavorable as defendant contends. I lay to one side the wells in the Bartlesville sand, for it appears to have pinched out before reaching this half section. But there are many wells in the Mississippi lime both to the northeast and to the southwest of this tract. The defendant's answer is that the Mississippi lime is too low under this lease to justify exploration. The lime under these 320 acres is from 570 to 610 feet below sea level,

[fol. 105] and much of the south half is between 570 and 590 feet. The map, prepared and introduced by the defendant, shows in the section adjoining on the southwest 23 producing wells where the lime is between 570 and 610 feet below sea level, and nine producing wells higher than 570 feet. It shows 18 producers within the 570-610 range in the field adjoining on the northeast, and three higher than 570 feet. There are dry holes between 590 and 610 feet, but there are dry holes as high as 564 feet. It is true that the wells are more productive on the higher spots in the lime, but there is no ground for condemning that part of this tract where the lime lies between 570 and 590 feet, for that is the bracket within which a large number of the adjoining producers were brought in.

Dry holes have been drilled in this field, two of them to the west of this lease. There are others to the southwest and the northeast, but there are also many producers there. The trend of the sand in the lime is undoubtedly under this lease, and part of it is at the depth where many wells have been brought in. Against these record facts, the defendant produces geologists whose opinions are adverse to drilling. But Mr. Moody, experienced with the fickleness of oil geology, knows too much to release this lease because of geologic guess. Their science is valuable to condemn the lease in court in justification of a failure diligently to develop; but he will not back their testimony by relinquishing the lease.

While the trial court made no specific finding upon the point, the decree entered must rest upon a finding that defendant has not complied with its implied obligation diligently to explore and develop the leased premises. I agree. The defendant company has tied up this half section for 17 years and has not drilled a single exploratory well thereon; it asks to hold it indefinitely in the future, with no hope of a well unless some other operator drills on adjoining land. Such conduct does not seem to me to square with the "due regard for the interests of the lessor" which was an integral part of its contract, under any rule of law or fair dealing.

I think the two small producing offset wells are enough to hold the forty on which they are situate. But I think a decree should enter that the lease as to the 320 acres be canceled unless, within a reasonable time, an exploratory well is drilled to the Mississippi lime.

[fols. 106 & 106a] IN UNITED STATES CIRCUIT COURT OF APPEALS

Before Honorable Robert E. Lewis, Honorable Orie L. Phillips and Honorable Sam G. Bratton, Circuit Judges

DECREE—Sept. 14, 1933

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Kansas and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this court that the decree of the said District Court in this cause be and the same is hereby reversed; that this cause be and the same is hereby remanded to the said District Court with directions to vacate the decree herein without prejudice to the bringing of a new suit, in the event changed conditions should indicate a breach of the implied covenant to develop; and that Mid-Continent Petroleum Corporation, a corporation, appellant, have and recover of and from Annie Sauder, Administratrix of the Estate of Philip Sauder, Deceased; Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, by Annie Sauder, her mother and next friend, Grace Annabell Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, minors, by Mina Sauder, their mother and next friend, appellees, its costs herein.

RECITAL AS TO ISSUANCE OF MANDATE

On October 24, 1933, the mandate of the United States Circuit Court of Appeals, in accordance with the opinion and decree of said court, was issued to the United States District Court and on October 26, 1933, the receipt of the clerk of the said District Court for said mandate was received and filed.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 107] SUPREME COURT OF THE UNITED STATES

ORDER EXTENDING TIME WITHIN WHICH TO APPLY FOR WRIT OF CERTIORARI—Filed Dec. 14, 1933

On consideration of the motion of counsel for petitioner in the above entitled cause, and good cause therefor having been shown,

It is Ordered that the time within which petition for writ of certiorari may be filed herein be, and the same is hereby, extended for a period of five days from this date.

Willis Van Devanter, Associate Justice of the Supreme Court of the United States.

Dated this 14th day of December, 1933.

[fol. 107a] [File endorsement omitted.]

[fol. 108] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed January 22, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 38,263. U. S. Circuit Court of Appeals, Tenth Circuit. Term No. 660. Annie Sauder, Administratrix of the Estate of Philip Sauder, Deceased, et al., vs. Mid-Continent Petroleum Corporation. Petition for a writ of certiorari and exhibit thereto. Filed December 15, 1933. File No. 660, O. T., 1933.

FILED OCT

SUPREME COURT OF THE

OCTOBER TERM,

No. 450

ANNIE SAUDER, Administratrix of the Estate of Peter Sauder, Deceased, ANNIE SAUDER, ALICE BLAIR STEARNS, ROBERT L. BLAIR, MYLES W. BLAIR, WILL M. MCLAUGHLIN, AS DOCTOR DIRECTOR, CHRIS TIE A. SAUDER, OLIVER J. SAUDER, AMOS W. SAUDER, LORINE F. SAUDER, [illegible] ANNIE SAUDER, HER MOTHER AND NEXT FRIEND, ALICE BELL SAUDER, HYBERT ALVIN SAUDER, RAY ARTHUR SAUDER AND LANE EVELYN SAUDER, MINORS, BY MRS. SAUDER, THEIR MOTHER AND NEXT FRIEND, PETITIONERS,

v.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS, TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

[illegible]

Harry W. Colbert,

[illegible]

[illegible]

Counsel for Petitioners.

Dixon, Kirkpatrick, Colbert And Conner,

Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1933

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED; ANNIE SAUDER, ALICE ELSIE STRAHM, SOPHIE E. ELROD, LILLIAN F. PINON, EMMA M. MEAGHER, GEORGE D. SAUDER, CHESTER A. SAUDER, OLIVER J. SAUDER, HAROLD W. SAUDER, LORENE I. SAUDER, A MINOR, BY ANNIE SAUDER, HER MOTHER AND NEXT FRIEND; GRACE ANNABELL SAUDER, EVERETT ALVIN SAUDER, RAY ARTHUR SAUDER AND IRENE EVELYN SAUDER, MINORS, BY MINA SAUDER, THEIR MOTHER AND NEXT FRIEND, PETITIONERS,

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, RESPONDENT.

PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THE COURT:

The petition of Annie Sauder, Administratrix of the Estate of Philip Sauder, deceased; Annie Sauder, Alice Elsie Strahm, Sophie E. Elrod, Lillian F. Pinon, Emma M. Meagher, George D. Sauder, Chester A. Sauder, Oliver

J. Sauder, Harold W. Sauder, Lorene I. Sauder, a minor, by Annie Sauder, her mother and next friend; Grace Annabell Sauder, Everett Alvin Sauder, Ray Arthur Sauder and Irene Evelyn Sauder, minors, by Mina Sauder, their mother and next friend, respectfully shows to this Honorable Court:

A.

Summary Statement of Matter Involved.

The petitioners are the heirs at law of Philip Sauder, who brought this suit to cancel the undeveloped portion of an oil and gas lease on 360 acres of land located in Greenwood County, Kansas (E ½; and SE ¼ SW ¼, Sec. 16, Twp. 23 South, Range 13 East) for failure to explore and develop, which lease, by mesne assignments, had passed to the respondent, Mid-Continent Petroleum Corporation, a Delaware corporation.

The trial court entered a decree canceling said lease except as to a tract 860 feet east and west, and 400 feet north and south located in the SE ¼ SW ¼, on which two producing wells had been drilled (R. 42-4). On appeal, the United States Circuit Court of Appeals, Tenth Circuit, reversed said decree without prejudice to the bringing of a new suit in the event changed conditions should indicate a breach of the implied covenant to develop. Circuit Judge McDermott dissented in a written opinion (67 F. (2d) 9, 13).

The question involved is whether the respondent lessee had breached its implied obligation to develop and explore (R. 46).

The lease, dated June 6, 1916, granted "the exclusive right" to enter upon, operate for and procure oil and gas, for 10 years from date "and as long thereafter as oil and gas *can* be procured thereon in paying quantities." The

lease provided that the lessors were to receive ⅛ of the oil realized, gas for domestic purposes, $100.00 per well per year during the time gas should be sold or marketed, and that if oil or gas be found on the premises all rights, benefits and obligations should continue so long as either could be procured in paying quantities (R. 6-8).

On November 1, 1921, and January 1, 1922, during the primary term of the lease, predecessors of the respondent completed two wells in the SE ¼ SW ¼ Sec. 16, which have ever since produced oil in paying quantities. These were offset wells to producing wells located in the NW ¼ of Sec. 21 and the SW ¼ of Sec. 16 (R. 23). There has been no further drilling on the Sauder lease during the 17 years since its execution (R. 22, 34, 48; Exh. 1, R. 67).

The petitioners' evidence proved the location, date of drilling, depth and initial production of the wells drilled on land bordering upon the land involved. It showed, and the court found, producing wells, as follows: *To the North and East*—in the SW ¼ of Sec. 10—16 wells; *To the East*—in the half section lying immediately east of the half section involved, being W ½ of Sec. 15—25 wells; *To the Southeast*—in the NW ¼ of Sec. 22—12 wells; *To the South*—on the half section lying immediately south of the land in question, being N ½ of Sec. 21—10 wells; *To the Southwest*—in the NE ¼ of Sec. 20—6 wells; *To the West*—in the SW ¼ of Sec. 16 and the SE ¼ of Sec. 17—7 wells. There are also two other scattered wells to the West and two to the North of the land in question. None of these wells is within 400 feet of the land in question except those to which the two wells in the SW ¼ of Sec. 16 are offsets. They are within 200 feet south and west thereof (Exh. 1, R. 67, 35).

Defendant's Exhibit E (R. 77) also shows these additional producing wells: 10 in the SE ¼ of Sec. 10; 18 in the East half of Sec. 15; 5 in the NE ¼ of Sec. 22; 11 in

the South half of Sec. 21; and approximately 40 in a southwesterly "trend" from the Sauder lease in Sections 20, 29 and 32. The East half of the Sauder lease is the only tract in a "trend" running northeasterly and southwesterly for a distance of 5 miles which does not have oil production (R. 56-7).

The respondent owns and is operating the SW ¼ of Sec. 15, lying East of the land in question, containing thereon 9 producing wells; also the NW ¼ of Sec. 22, lying Southeast of the land in question, with 12 producing wells thereon, and the North half of Sec. 21, lying immediately South of the land in question, with 9 producing wells thereon (Exh. 1, R. 67).

The wells to the East of the Sauder lease are producing from the Bartlesville sand which is found in long, narrow strips averaging about 3 well locations (a width of 460 feet per location) (R. 51). The best wells were had by drilling in the middle or crest of this sand and the locations to the West toward the East side of the Sauder lease, or to the East in the opposite direction, showed the sand to be thinner with more water and less oil (R. 51, 55, 60).

The wells on the Sauder lease and those to the South and West are producing from the Mississippi lime, which underlies the Bartlesville sand (R. 51, 55, 60-1-2, and 64). A geologist, who had never been on the lease involved, gave as his opinion that there was an absence of oil in paying quantities in the Mississippi lime underlying the Sauder lease, for the following reasons: (1) Said lime formation produces oil at a higher point and is barren of oil at its lower points; that is, the oil is found where the lime is near the surface (R. 61); (2) The formation dipped in every direction except from the Northwest to the Southwest (R. 61); (3) Wells encountered in the lime at a greater depth than 570 feet below sea level in the vicinity of the Sauder lease were usually dry holes or produced oil in

negligible quantities (R. 60-1; Exh. E, R. 77); (4) Three dry holes were drilled near the Sauder lease, one in the SE ¼ of Sec. 9, 1,880 feet North of the North line and 200 feet West of the East line extended of the Sauder lease; one in the NW ¼ of Sec. 16, 630 feet West of the West line and 290 feet North of the West line of the Sauder lease, and 290 feet North of the center line of Sec. 16; another in the SW ¼ of Sec. 16, 200 feet West of the West line and a thousand feet North of the South line of the lease; and a well in the SW ¼ of Sec. 15, 750 feet East of the East line of the Sauder lease did not produce oil in paying quantities. The two wells drilled in the Sauder lease reached the lime at 558 and 574 feet respectively (R. 77; Exh. E).

The lime under the Sauder 320 acres is from 570 to 610 feet below sea level and much of the South half is between 570 and 590 feet below sea level (R. 77; Exh. E). In the section adjoining on the Southwest (E ½ of Sec. 20 and W ½ of Sec. 21) there are 23 producing wells where the lime is between 570 and 610 feet and 9 wells higher than 570 feet. In Sec. 29, lying next further Southwest, there are 20 producing wells between the 570-610 feet range and in the field adjoining on the Northeast there are 17 producing wells within the 570-610 feet range and 3 higher than 610 feet. There are dry holes between 590 and 610, but there are also dry holes as high as 564 feet (Exh. E, R. 77).

The respondent, defendant below, introduced opinion evidence of its Vice-President in charge of production, its District Superintendent in charge of production, a geologist in its employ, and the Superintendent of another drilling company to the effect that, taking into consideration the development both on the lease and surrounding leases, the cost of drilling and equipping a well, and the probability of encountering paying production and other available facts, that no prudent operator would have drilled

another well on the Sauder lease (R. 51, 55-6, 61, 64-5). The Vice-President testified that the dry hole at Theta well No. 2, located 1,880 feet North of the North line of the Sauder lease, and the small production at Viola M. Briglin "B", No. 1, 760 feet South of the South line of said lease, tended to prove that oil did not exist in paying quantities under the Sauder lease (R. 50). Generally these witnesses testified as to their opinion founded on practical experience and watching developments, but stated that their theories might be wrong; that they did not want to tell the court that they could tell where there was oil; and that if a well had been drilled in the middle of the lease involved, information could have been secured which was not now possessed and such information might change the facts upon which their theories and conclusions were based; and that the only way to be absolutely certain as to whether there were any oil in the lime under the involved half section was by drilling a well (R. 54, 56-7, 62-3); that oil had been produced in Greenwood County for years (R. 58).

The defendant's evidence also showed that the half section in question was worthless from the standpoint of future development; that if it were later developed that production could be obtained, the defendant would be willing to develop it; but the purpose of the defendant was to hold the lease without any further development, or until somebody else developed something or until it gained information itself, but it had no immediate intention of developing the lease involved; and that its geological record showed that the Northwest corner of the lease had not been developed as thoroughly as around the edges of it, and that it was not impossible of further development in that Northwest corner (R. 52-3).

After stating that the defendant's expert witnesses had testified positively that in their judgment none of the production adjacent to the Sauder lease was draining any

oil therefrom, but admitted that they might be mistaken as there was no absolute way of determining the drainage except by drilling tests, the trial court found:

> "This evidence as to drainage is not wholly convincing to the court. There is, in the opinion of the court some probability that damage is being done to this leasehold by drainage to the adjoining properties;" (R. 35).

After stating that the plaintiffs contended that a well-defined "trend" of oil producing sand and lime runs in a southwesterly-northeasterly direction under and across the land described in said lease, and that the defendant's expert evidence tended to prove that no such "trend" exists under said land, but that on the contrary the oil sand is not to be found thereunder and the lime is at such depth that the probabilities are that no oil would be found in it, the court found:

> "On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive tests by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant, nor any of its predecessors in title, have drilled any well on the East half of Sec. 16, but no dry well has been drilled on any of the property covered by said lease" (R. 36).

The court further found:

> "That on June 16, 1926, Philip Sauder wrote a letter to the defendant company calling attention to the ten year term, that no wells had been drilled except the two heretofore mentioned and demanded that the defendant proceed to explore and develop by the drilling of additional wells or release its claim to all of the

land except that part on which wells had been drilled and were producing oil. On June 25, 1926, the company replied that it considered said lease a valuable one and would not surrender it (R. 36).

"No effort has been made by the defendant and its officers and employes toward exploration or development and the evidence in this case shows that the defendant and its officers and employes have no present intention of further exploring or developing said lease and no intention of ever developing said lease unless and until further developments in the immediate vicinity thereof might convince said defendant that it would pay the defendant to further explore or develop said lease (R. 36).

"Evidence of the defendant tends to show that the land covered by the lease is worthless for drilling purposes * * *. If the lease is worthless, as contended by defendant, it is neither equitable nor just to permit the defendant to continue to hold the lease except as upon the 10 acres where the two offset wells are located.

"I think the question of the defendant's diligence in exploring the premises is of paramount importance. * * * I am compelled to conclude that the defendant has not shown that diligence in exploring and developing the land in question as is required under the law, equity and good conscience" (R. 37-40).

And concluded as a matter of law that:

"The defendant and its predecessors in title have not in good faith and with reasonable diligence explored and developed the lands described in this lease in accordance with the express and implied covenants of said lease.

"It would be inequitable and unjust to permit the defendant to hold, keep, and retain the leasehold property involved herein without further exploration or development, as said defendant proposes to do, as shown in the pleadings and evidence herein" (R. 40).

The Circuit Court of Appeals held that there was an implied covenant on the part of the lessee to drill such wells as under the circumstances an operator of ordinary prudence, having regard for the interests of both lessor and lessee, would drill; that the trial court did not find that the Petroleum Corporation had breached such implied obligations and that such a finding would have been wholly without support from the evidence (R. 95-6).

The Supreme Court of Kansas, in *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500 (decided June 12, 1926), had applied a different measure of diligence to the implied covenant to develop. There it held that a lessee could not hold a lease on 160 acres by drilling a single producing well, that there was an implied covenant fairly to exhaust the capabilities of the land and produce the minerals, and that if the undeveloped part will not produce minerals in paying quantities, and the lessee is not justified in drilling more wells, he cannot continue to hold by virtue of a provision in the lease extending the term to so long as oil or gas be produced in paying quantities (R. 95).

The majority opinion held that the trial court's decision was predicated on *McCarney* v. *Freel* (*supra*) conceded by counsel to support the trial court, distinguished it from the case at bar because there the decree was predicated on a breach of the implied covenant whereas there was no breach in the instant case and further held that since *McCarney* v. *Freel* (*supra*) was decided long after the Sauder lease was entered into, that that opinion was not binding upon the Federal courts and, as that court could not subscribe to the doctrine of *McCarney* v. *Freel* because it imposed a greater obligation under the implied covenant to develop than is recognized by the great weight of authority or placed an obligation on the lessee not imposed by the lease contract, it would exercise its own in-

dependent judgment as a court of equity. It therefore followed and applied the principles announced by it in *Denker* v. *Mid-Continent Petr. Corp.*, (C. C. A. 10) 56 F. (2d) 725, a case decided in 1932 and involving an oil and gas lease on Oklahoma land (Brief pp. 24-25).

Judge McDermott, dissenting, held that the rights of a holder of an oil and gas lease constitute rules of property to be governed by decisions of the Kansas court; reviewed the Kansas cases both prior and subsequent to the execution of the Sauder lease, and held that *McCarney* v. *Freel* did not overturn any settled rule of property law in Kansas, but is in accord with the current of Kansas authority (R. 98-103), and that either before or after 1916, the date of the Sauder lease, the Kansas court would not permit a lessee to hold 320 acres of land for 17 years without exploration or development, and that the Federal Court should apply the Kansas law and cancel the undeveloped part of the lease (R. 103); that if he were wrong in his construction of the earlier Kansas decisions, the question was at least an open one at the time the interest in the real estate was acquired, and in that event the rights of the parties should be governed by the later decisions of the Kansas courts in 1918 and 1926 rather than by the later decision of the Federal court in 1932; that if the lessee of the Sauder lease were a resident of Kansas, the lessor would be entitled to cancellation, and that the majority was permitting a non-resident corporation to acquire a greater interest in Kansas real estate than a resident might acquire (R. 98, 104).

Judge McDermott further held that if the Kansas decisions are to be ignored the same result should obtain, because a prudent operator, having regard for the interests of the lessor as well as his own, ought not to hold 320 acres almost surrounded by oil wells, without drilling a test well,

and that in common fairness he ought to give the lessors a well or get off and let someone else drill it; that tying up a half section of land for 17 years without drilling a single exploratory well, and with no hope of one unless some other operator drills on adjoining land, does not square with "due regard for the interest of the lessor" and constitutes a breach of the implied covenant diligently to explore and develop (R. 105).

B.

Reasons Relied on for the Allowance of the Writ.

In an action to cancel an oil and gas lease on Kansas real estate, for failure to explore and develop, the Circuit Court of Appeals erred:

1. In deciding an important question of local law in a way which is in conflict with applicable local decisions, in that:

(a) It has refused to follow and apply the decisions of the Kansas courts, to the effect that the implied covenant in an oil and gas lease to fairly exhaust the capability of land to produce mineral, requires that developing be done by drilling, and that if the land will not produce minerals, or the lessee is not justified in drilling, he cannot continue to hold it by virtue of a provision extending the lease term so long as oil or gas be produced in paying quantities.

(b) While holding that the measure of diligence in developing an oil and gas lease was "that which, under the circumstances, an operator of ordinary prudence, having regard to the interests of both the lessor and lessee, would do," it has interpreted and applied that measure contrary to the rules of property law established by the decisions of the Kansas courts;

2. In refusing to subscribe to the decisions of the Kansas courts affecting title to real estate, because they impose a greater obligation under the implied covenant to develop an oil and gas lease than is recognized by the great weight of authority, it has departed from the accepted and usual course of judicial proceedings and created a conflict of decisions with the Eighth Circuit as announced by it in *Thurlow* v. *Waite-Phillips Oil Co.*, 22 F. (2d) 781, wherein that court in an action affecting title to an oil and gas lease on Kansas land, followed the decisions of the Kansas court as controlling authority, even though said decisions, in its judgment, produced a patent and burdensome injustice;

3. In refusing to follow and apply the decisions of the Kansas courts affecting title to real estate; it decided an important question in a way probably untenable and in conflict with the weight of authority and of the principle announced by this court in *Edward Hines Trustees*, v. *Martin*, 268 U. S. 458, wherein it was held that Federal courts will follow the decisions of the state courts which have established a rule affecting title to real estate within the state;

4. That the decision of the Circuit Court of Appeals demonstrates how, since *Swift* v. *Tyson*, 16 Peters 1, 10 L. Ed. 865, the Federal courts have constantly increased the range of questions as to which they regard themselves not bound by the decisions of the state courts, and has brought about a situation where diverse citizenship, instead of preventing a discrimination against a non-citizen, results in a discrimination in his favor and against the citizen, and instead of making one law for all in a state makes different laws for a citizen and non-citizen accompanied by an increasing demand to abolish jurisdiction based on diverse citizenship. The result is such a bewildering confusion that the court should adequately define or limit such phrases as: "Rule

of property," "Local law," and "Questions of jurisdiction," to the end that the tendency of the Federal courts to depart from state decisions should be limited rather than extended further and to the end that there be uniformity of decision in the Federal and State courts.

C.

Questions Presented for Review by the Court.

The questions presented for review by the Court are:

1. Did the Circuit Court of Appeals err in refusing to follow, as the established law of Kansas, the principle that the implied covenant in an oil and gas lease to fairly exhaust the capability of land to produce mineral, requires that developing be done by drilling, and that if the land will not produce minerals or the lessee is not justified in drilling, he cannot continue to hold it by virtue of a provision extending the lease term so long as oil or gas be produced in paying quantities.

Wherefore, Your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding that court to certify and to send to this Court, for its review and determination, on a day certain to be therein named, a full and complete transcript of the record of all proceedings in the case numbered and entitled on its docket No. 773, Mid-Continent Petroleum Corporation, a Corporation, appellant, *v.* Annie Saunder *et al.*, appellees, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court of Appeals may be reversed by this Honorable Court and that

your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just. And your petitioners will forever pray.

ANNIE SAUNDER ET AL.,
By HARRY W. COLMERY,
RAY S. PIERSON,
BALFOUR S. JEFFREY,
Counsel for Petitioners.

DORAN, KLINE, COLMERY & COSGROVE,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Court Below.

The opinion of the United States Circuit Court of Appeals, Tenth Circuit (R. 91), sought to be reviewed is reported as Mid-Continent Petroleum Corporation *v.* Sauder *et al.*, 67 F. (2d) 9; the dissenting opinion of Judge McDermott, at page 13.

II.

Jurisdiction.

1. The date of the decree to be reviewed is September 14, 1933 (R. 91);

2. The claims advanced and rulings made by the Circuit Court of Appeals, here relied upon as the basis of this Court's jurisdiction, are as follows:

(a) The Circuit Court of Appeals erred in refusing to follow the Kansas decisions to the effect that the implied covenant in an oil and gas lease to fairly exhaust the capability of land to produce mineral, requires that developing be done by drilling, and that if the land will not produce minerals or the lessee is not justified in drilling, he cannot continue to hold it by virtue of a provision extending the lease term so long as oil or gas be produced in paying quantities;

3. The jurisdiction of this Court is invoked under Sec. 240 of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U. S. C. A. 347);

4. The cases believed to support the jurisdiction of this Court are:

Edward Hines Trustees v. *Martin,* 268 U. S. 458, 45 Sup. Ct. Rep. 543, 69 L. Ed. 1050;

Black & W. Taxicab Co. v. *Brown and Y. Taxicab Co.,* 276 U. S. 518, 48 Sup. Ct. Rep. 404, 72 L. Ed. 681;

Guffey v. *Smith,* 237 U. S. 101, 35 Sup. Ct. Rep. 526, 59 L. Ed. 856;

Hartford Ins. Co. v. *Railway,* 175 U. S. 91, 20 Sup. Ct. Rep. 33, 44 L. Ed. 84, 89.

III.

Statement of the Case.

The facts material to the matter involved and the issues raised in the Circuit Court of Appeals have been stated in the petition (Point A, pp. 2-11) which is hereby adopted and made a part of this brief.

IV.

Specification of Errors.

1. The Circuit Court of Appeals erred in refusing to follow the Kansas decisions which established the obligation of a lessee under an oil and gas lease to explore and develop.

2. The Circuit Court of Appeals erred in holding that there was no breach of the implied covenant to explore and develop (R. 96).

V.

ARGUMENT.

A. The Circuit Court of Appeals Erred in Refusing to Follow the Kansas Decisions Which Had Established the Obligation of the Lessee Under an Oil and Gas Lease to Explore and Develop.

1. *The Kansas decisions established the rule of law that there is an implied covenant in an oil and gas lease to*

fairly exhaust the capability of land to produce minerals, and that if the undeveloped portion will not produce minerals in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of the provision in the lease extending the term so long as oil and gas is produced in paying quantities.

The above principle has been established by a line of decisions of the Supreme Court of the State of Kansas.

Mills v. *Hartz*, 77 Kan. 218, 94 Pac. 142 (1908), was an action to cancel a lease giving "exclusive right to dig, bore and mine for gas, petroleum oil and coal," for twenty years, and as much longer as said minerals were produced in paying quantities. Lessor was to receive a royalty per ton, gas for domestic purposes, and $50 per annum for gas obtained from each well. The lessee did no developing and, after 7½ years, this action was brought to cancel the lease for his failure to explore and develop. He contended that the lease did not provide for immediate exploration, but that he had twenty years to explore and develop. In sustaining the ruling of the trial court canceling the lease and the contention that the lease was granted upon an implied condition that the lessee should explore and develop within a reasonable time, the court stated the principles governing mineral leases as follows:

> "The only consideration moving to the lessor for the right which he gave to the lessee to explore and procure minerals was the royalty on the coal to be found and the fixed compensation for each well when gas should be found and utilized, together with sufficient gas to supply two stoves in his farmhouse. If there were no search, nor any product, no possible benefit could come to the lessor for the exclusive rights which had been given to the lessee. It is not easy to infer that the lessor intended to give a valuable right for a nominal consideration, and permit the lessee to

retain the right for a period of twenty years without development, when development was the chief purpose in the execution of the lease. Neither the character of the right given nor the nature of the instrument admits of such an irrational interpretation. The lease contemplates that the lessee shall proceed to dig and bore for gas, oil and coal, and that the lessor shall obtain gas for his farmhouse, not twenty years hence, but as soon as it can reasonably be procured."

l. c. 220.

In quoting from *Huggins* v. *Daley*, 40 C. C. A. 12, 48 L. R. A. 320, the court said:

"There is, perhaps, no other business in which prompt performance is so essential to the rights of the parties, or delays so likely to prove injurious—no other class of contracts in which time is so much of the essence."

"No such lease should be so construed as to enable the lessee who has paid no consideration to hold it merely for speculative purposes, without doing what he stipulated to do, and what was clearly in the contemplation of the lessor when he entered into the agreement."

l. c. 222.

In *Howerton* v. *Gas Company*, 81 *Kan.* 553, 106 Pac. 47, (1910), an action to cancel an oil and gas lease which provided that a well should be drilled in one year with one-tenth royalty of oil delivered to the lessor, and, if gas was found in paying quantities, $50.00 per year for each gas well, a gas well was completed within the year and the production had in commercial quantities sufficient to justify the expense of marketing, but failed to market the gas. In holding that this failure was equivalent to a failure to explore at all (560), the court stated principles and quoted from authorities as follows:

"It is unreasonable to suppose that it was understood that the completion of one well, without operation or production, except to furnish gas for the plaintiff's home, was all that the lessee was bound to do for more than four years, in which time, it might be fairly presumed, many wells would be drilled in near-by territory and gas marketed therefrom, as in fact actually occurred."

" 'Generally all leases of land for the exploration and development of minerals are executed by the lessor in the hope and upon the condition, either express or implied, that the land shall be developed for minerals; and it would be unjust and unreasonable, and contravene the nature and spirit of the lease, to allow the lessee to continue to hold under it any considerable length of time without making any effort at all to develop it according to the express or implied purpose of the lease; and, in general, while equity abhors a forfeiture, yet, when such a forfeiture works equity, and is essential to public and private interests in the development of minerals in land, the landowner, as well as the public, will be protected from the laches of the lessee and the forfeiture of the lease allowed, where such forfeiture does not contravene plain and unambiguous stipulations in the lease. This principle will be more readily enforced and applied by the court as to gas-and-oil cases because of the peculiar nature of those minerals and the danger of entire loss to the lessor of oil or gas in his lands by reason of well drilling on adjacent lands.' " 11 L. R. A.—n. s., 417.

l. c. 558, 559.

" 'In grants of the character in question, the title is inchoate, and for the purpose of exploration only, until oil or gas is found in quantities warranting operation; and while the courts manifest a disposition to protect the grantee at this stage by treating his interest as no longer postponed to the happening of a condition precedent, yet it is thoroughly settled that he can not omit to develop the property and hold the grant for speculative purposes purely.' "

"'The duty to develop the property upon the discovery of oil or gas in paying quantities is not to be regarded as a mere implied covenant, but, in a case like this, where practically the whole consideration must depend upon the implied undertaking, is to be treated as a condition subsequent.' (*Gadbury* v. *Ohio, etc., Gas Co.*, 162 Ind. 9, 14, 15.)"

l. c. 559, 561.

"'* * * The testing provided for in such case was of the very essence of the contract, not only with respect to the time within which it was to be done, but as to the thoroughness and certainty with which the mineral value of the lands should be ascertained. * * * The 'testing' provided for was manifestly a condition upon which the lease depended. If such test showed no minerals, then the contract was at an end; if it, on the other hand, showed the presence of valuable mines then the lessees were bound to operate them in good faith for the joint profit of themselves and the owners of the fee. * * *' *Petroleum Company* v. *Coal, Coke, and Manufacturing Company*, 89 Tenn. 381, 388, 389.)"

The court cancelled this lease, but, in subsequent decision, reversed the decree of cancellation and provided that the lessor should prove its damages at a trial, but that if it should be ascertained that such rule could not be applied, an alternative decree should be entered requiring the lessee to proceed, within a reasonable time, fixed by the court, to drill wells and protect the land leased and, upon his failing to do so, that the lease be cancelled. In this case, the court approved the principles hereinabove quoted from the first opinion. 82 Kan. 367, 108 Pac. 813.

In *Culbertson* v. *Cement Company*, 87 Kan. 529, 125 Pac. 81, (1912), although the facts are different, the following principle announced is applicable:

"Since the number of wells to be drilled on the land was not specified there was an implied obligation on

appellants to fully develop the land and put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas."

l. c. 535.

In *Day* v. *Kansas City Pipe Line Company*, 87 Kan. 617, 125 Pac. 43, (1912), a judgment was entered cancelling a gas lease. There were eight producing wells on two 80-acre tracts, included in a single lease covering 600 acres. Although the primary term had not expired, an action was brought to cancel the lease, and the decree cancelling the same as to 440 acres, upon which no wells had been drilled, was affirmed. The case is distinguishable in that there was an express covenant "to continue drilling as long as paying wells are found or royalties paid." The following statements are applicable:

"Appellant says that the lease does not expressly provide how many wells should be sunk on the land; that in the development two dry holes were drilled, and that it had reason to believe that further drilling would be attended with great risk and many dry holes be found, and as each costs a large sum of money it was not required to run that risk. It also says that the number of wells which shall be sunk on land is not to be determined by the landowners, nor yet by the courts; but is to be determined by the operator so long as he acts in good faith."

l. c. 622.

"The appellant was, of course, not required to develop land that had been tested and found to be unprofitable for operation, but if paying wells could not be found on the land or any part of it there is no reason why appellees' title should be longer clouded with a barren encumbrance nor any reason why appellant should resist a cancellation."

l. c. 623.

In *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005 (1918), the lessor executed a lease in 1902 covering two tracts of land, one of 220 acres and one of 716 acres. There were twenty-five producing wells on the larger tract, but no exploration was made of the smaller. The primary term had expired. The Supreme Court stated that "it is not the province of the courts to end a contract merely because it is a bad bargain," that "the plaintiff asks the court to cancel this contract, to decree a forfeiture of it, and not for default of any expressed provision of the contract but merely for the default of one of its implied covenants. The instances are rare where equity will enforce a forfeiture. It will never do so where less drastic redress will satisfy the demands of justice." Then, citing its earlier decisions, the court said:

> "Unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease, and as it stands it is of no value to defendants. Unless the defendants had a *bona fide* intention to prospect and develop this tract they had no proper purpose in leasing it, and to cancel the lease will do them no injury. While equity abhors forfeiture it likewise abhors injustice."
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> l. c. 406.

Thereupon, the court directed that the lease be cancelled as to the 220 acres unless the lessee developed it within a reasonable time.

In *Webb* v. *Croft*, 120 Kan. 654, 224 Pac. 1033, the primary term had expired. The lease covered 580 acres, and there was one producing well thereon. The closest development to the lease were two wells, each three-quarters of a mile away. The trial court entered a decree requiring the lessee to develop or cancel. The Supreme Court, in affirming said decree, held, upon the authority of its earlier decisions, that:

"Leases of this kind contemplate exploration and development and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both the lessor and lessee. (*Howerton* v. *Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Id.*, 82 Kan. 367, 108 Pac. 813; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; *Harris v. Ohio Oil Co.*, 57 Ohio St. 118.) The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land by drilling such number of wells as an ordinarily prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling."

l. c. 657.

"We think the court rightly concluded that the land of defendants has not been sufficiently developed. It would be grossly inequitable to hold a tract of 580 acres with no more development than has already been made. Plaintiff was entitled to some remedy for the failure to develop it, and we think it was competent for the court, instead of decreeing a cancellation of the lease, to give the defendants an opportunity to make reasonable development of the land pursuant to their implied covenants, as has already been determined in *Alford* v. *Dennis, supra.*"

l. c. 658.

McCarney v. *Freel*, 121 Kan. 189, 246 Pac. 500 (1926), was an action to cancel an oil and gas lease dated June 15, 1912, for ten years and as much longer as oil and gas could be produced in paying quantities. It embraced a

quarter section of land. In October, 1912, a well was drilled which produced and still was producing oil in paying quantities. In November, 1917, a dry hole was drilled. No further effort was made to develop, although there were numbers of producing wells drilled and in operation on surrounding land. In affirming the decree of cancellation, the court said:

> "Plaintiff's evidence warranted the inference that defendants have not reasonably developed her land, and have no present intention to do so. * * * The testimony in support of the defense was, a man would not be justified in drilling any more wells on plaintiff's land. The court canceled the lease, except as to a tract having a radius of 200 feet surrounding the producing well.
>
> "The judgment was correct, whether based on plaintiff's or on defendants' theory of the case. A lessee may not hold an entire quarter section of land with a single producing well after expiration of term, any more than he may do so before expiration of term. The implied covenant fairly to exhaust capability of the land to produce mineral, subsists. If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."
>
> l. c. 190.

The foregoing decisions constitute an unbroken line of precedent establishing the law of implied covenant to develop and explore an oil and gas lease in the state of Kansas, support the findings of the trial court and compel a result different from that arrived at by the Circuit Court of Appeals. It followed the rule that the measure of diligence is what, under the circumstances, an ordinary prudent operator would do, having regard to the interest

of both lessor and lessee, following its prior opinion in *Denker* v. *Mid-Continent Petr. Corp.* (C. C. A. 10, 56 F. (2d) 725), involving the cancellation of an oil and gas lease on land in Oklahoma. This was not the law in Kansas either before or after the execution of the Sauder lease. The Mills, Howerton, Culbertson, and Day cases (*supra*) established the principle contended for by petitioners prior to 1912. Immediately after the lease was made there came *Alford* v. *Dennis*, *Webb* v. *Croft*, and *McCarney* v. *Freel* (*supra*), in rapid succession and all without any intimation by the Kansas Supreme Court that there was even a scintilla of conflict with the earlier cases. They establish that there has been no change in the rule of property involved applicable to the instant case.

2. *The Kansas decisions, with reference to the obligation to explore and develop constitute rules of property, are binding on the Federal court and should be followed by them.*

The binding effect of state decisions in Federal courts has been the subject of much comment and extensive litigation since *Swift* v. *Tyson*, 16 *Peters* (U. S.) 1 (1842), 10 L. Ed. 865 (Note 1). But in announcing the doctrine of

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NOTE 1: A comprehensive view of comment and litigation may be obtained from a few citations: Warren, History of Federal Judiciary Act of 1789, 37 Harvard Law Review, 49; Pepper, The Border Line of Federal and State Decisions; William Trickett, The Non-Federal Law Administered in Federal Courts, 40 Am. L. Rev. 819; Frankfurter, Distribution of Judicial Power between United States and State Courts, 13 Cornell Law Quarterly, 499; Sharp and Brennan, The Application of the Doctrine of *Swift* v. *Tyson* since 1900, 4 Indiana Law Journal 367; Meigs, Decisions of the Federal Courts on Questions of State Law, 45 Am. L. Rev. 47; 1 Beale, Conflict of Laws (1916) Sec. 112*a*; Dobie, Federal Procedure (1928) Sec. 142; Note 40 L. R. A. (N. S.)

Swift v. Tyson, Mr. Justice Story, by specific languag excepted from its application, and left under the bindi effect of state decisions "* * *" rights and titles to thing having a permanent location, such as the rights and titl to real estate, and other matters immovable and intrate ritorial in their nature and character." *Swift* v. *Tyso* (*supra*) at page 18. That case further excepted the fiel of law governed by rules of a local nature and not pred cated upon general common law.

In Kansas, it has been held that an oil and gas lease co veys an interest in real estate. *Robinson* v. *Smalley*, 1 Kan. 842, 171 Pac. 1155; *Huston* v. *Cox*, 103 Kan. 73, 1 Pac. 992; *Brinkman* v. *Empire Gas and Fuel Co.*, 120 Ka 602, at 607, 245 Pac. 107.

(a) *The rule of property contended for was establishe by Kansas decisions prior to the date of the Sauder leas and should have been followed.*

It is submitted the line of Kansas decisions, cited abov and decided prior to the date of the lease in this case, hav established a rule of property, and action, in Kansas, whic should have been accepted by the Circuit Court of Appeal

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380; Note 71 A. L. R. 1102; Note 57 A. L. R. 435; *Kuhn* v *Fairmont Coal Company*, 215 U. S. 349, 30 Sup. Ct. 14 54 L. Ed. 228; *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. C 526, 59 L. Ed. 856; *Black & W. Taxicab Company* v. *Brow and Y. Taxicab Company*, 276 U. S. 518, 48 Sup. Ct. Re 404, 72 L. Ed. 681; *Hines Trustees* v. *Martin*, 268 U. S. 45 45 Sup. Ct. 543, 69 L. Ed. 1050. The result of the wide ex tension of the doctrine has led to serious proposals t abolish Federal jurisdiction based upon diversity of citizen ship. 15 A. B. A. Journal 401, and has led to suggeste legislation to require Federal Courts to follow state de cisions in all law except Federal questions. Senate Resolu tion 4333, 69th Congress, 1st Session. U. S. Daily, May 1928, page 585.

as binding upon its decision. *Warburton* v. *White*, 176 U. S. 484, 20 Sup. Ct. Rep. 404, 44 L. Ed. 555; *Abraham* v. *Casey*, 179 U. S. 210, 218, 21 Sup. Ct. 88, 45 L. Ed. 156; *Walker* v. *State Harbor Commission*, 17 Wall. 648; *Barrett* v. *Holmes*, 102 U. S. 651, 26 L. Ed. 291; *Bucher* v. *Cheshire Rwy.*, 125 U. S. 555, 8 Sup. Ct. 974, 31 L. Ed. 795; *East Central Eureka Company* v. *Central Eureka Company*, 204 U. S. 266, 27 Sup. Ct. 258, 51 L. Ed. 476; *Hartford F. Ins. Co.* v. *Chicago, M. & St. Paul R. Co.*, 175 U. S. 91, 44 L. Ed. 84, 89, 20 Sup. Ct. Rep. 33. A Federal court was held bound by Kansas state decisions as to whether an oil and gas lease of riparian land carries the right to drill in land formed by accretion. *Thurlow* v. *Waite-Phillips Oil Co.* (C. C. A. 8), 22 F. (2d) 781, certiorari denied 278 U. S. 598, 49 Sup. Ct. 8, 73 L. Ed. 528, and the decision of the state court upon a question peculiar to mining leases was followed in *Foster* v. *Elk Fork Oil & Gas Company*, 32 C. C. A. 560, 90 Fed. 178.

The exception to *Swift* v. *Tyson* has been extended to include questions relating to rights in personal property. *Dooley* v. *Pease*, 180 U. S. 126, 21 Sup. Ct. 329, 45 L. Ed. 457; *Bryant* v. *Swofford Co.*, 214 U. S 279, 29 Sup. Ct. 614, 53 L. Ed. 997.

In *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. Ed. 856, it was held where an oil and gas lease under the decisions of Illinois state court constituted an interest in realty, that the decisions of the highest courts of the state in which the property is situated are accepted and applied by the Federal courts as rules of property.

The attention of the Court is respectfully called to the decisions set out in the next point following, which are equally pertinent and applicable to the subject matter of this subdivision.

(b) That some of the Kansas decisions touching the principle contended for, were made after the Sauder lease was executed, does not compel a different result.

Judge Phillips, writing for the majority in the case at bar (R. 91), prefers to disregard the Kansas rule because three of the cases (*Alford* v. *Dennis*, *Webb* v. *Croft*, *McCarney* v. *Freel*, *supra*), the last of which it is admitted would decide this case if of effect in the Federal court, were decided after the lease between the parties was made (R. 96). That position was sought to be justified by the authority of *Kuhn* v. *Fairmont Coal Company*, 215 U. S. 349, 30 Sup. Ct. 140, 54 L. Ed. 228.

It is to be noted that in the case at bar there was a line of Kansas cases in existence before the lease was made, all of which established the Kansas rule contended for. In addition, there were two cases decided immediately after the lease was made, the language of which was very much in point, followed by the *McCarney* v. *Freel* case, all of which were decided from 14 to 6 years before *Denker* v. *Mid-Continent Petr. Corp.*, 56 F. (2d) 725, 84 A. L. R. 756, which is principally relied upon by the Circuit Court of Appeals in reaching its result in this case. The Denker case arose from the District Court of Oklahoma, and it is a fair inference that the trial court was applying Oklahoma law, and the citation of authorities in opinion of the Circuit Court, convinces that it was likewise. It cannot be the purpose of the Kuhn case to impose upon residents of Kansas the rule of property of Oklahoma, adopted by the Federal Circuit Court of Appeals, in a case arising from that state.

While th facts existed in the case at bar, the question certified in the Kuhn case was whether a single state decision, decided after the Federal action was brought, was decisive in an action in the Federal court. 215 U. S. at

356. It was held that the state decision did not bind the Federal court, which could decide the question according to its own law, but having regard for the state decision. Three Justices dissented from the doctrine and the result reached in that case.

In the Kuhn case, there was only a single state decision ruling on the proposition of law, and that made after the action in the Federal court had commenced. The rule of applying the state law in the Federal courts, where property rights are involved, has required that the state law be established. The Federal courts hesitate to follow a single or individual decision of the state courts, and prefer to follow a line of decisions establishing a rule. *Lane* v. *Vick*, 3 How. 464, 11 L. Ed. 681; *Chesko* v. *Delaware & H. Company*, 218 Fed. 804; *Pineland Club* v. *Robert* (C. C. A. 4), 213 Fed. 545, 556; *Lewis* v. *Alwood*, 228 Fed. 853.

It is a great distance from *Kuhn* v. *Coal Company* to the case at bar, and it must first pass the hurdle of the unanimous decision of this Court in *Edward Hines Trustees* v. *Martin*, 268 U. S. 458 (1925), 45 Sup. Ct. 543, 69 L. Ed. 1050, which was apparently not considered by the Circuit Court of Appeals. That case was an equitable action to remove a cloud on title to some real estate, and it was held that repeated decisions of the state courts, establishing a rule of property in the state, will be followed by the Federal courts without inquiry into the correctness of the rule as an original question.

In that case, the petitioners' title depended upon a patent issued June 27, 1871, and the defendant's title was acquired through a second patent of December 7, 1883, both patents being issued by the State of Mississippi. Thereafter, by cases decided in 1888, 1917 and two cases in 1924, the Supreme Court of Mississippi made decisions determining the law governing the rights and title to land pro-

ceeding from patents and situations similar to the Hines case. Mr. Justice Stone, writing for this Court, said:

> "But where the rule is one affecting title to real estate within the State and has been repeatedly determined by decisions of state courts so that it is established as the law of the State, there has been no departure from the rule that the federal courts will follow the decisions of the state courts. *Jackson ex dem St. John* v. *Chew, supra; Green* v. *Neal*, 6 Pet. 291; *Suydam* v. *Williamson*, 24 How. 427; *Walker* v. *The State Harbor Commissioners*, 17 Wall. 648; *Barrett* v. *Holmes*, 102 U. S. 651. And this is the rule even though the state rule is not approved. *Walker* v. *The State Harbor Commissions, supra; Bucher* v. *Cheshire Railway Co.*, 125 U. S. 555; *Balkam* v. *Woodstock Iron Co.*, 154 U. S. 177. To avoid the uncertainty and injustice which result from 'the discordant element of a substantial right and which is protected in one set of courts and denied in the other, with no superior to decide which is right' (*Brine* v. *Insurance Company*, 96 U. S. 627), this Court has not hesitated, when there has been a conflict of decision between it and the state courts affecting a rule of property within the State, to overrule its own decisions and to follow the state decisions, once it has become evident that they have established a 'rule of property' as the settled law of the State. *Green* v. *Lessee of Neal*, 6 Pet. 291; *Suydam* v. *Williamson, supra; Fairfield* v. *County of Gallatin*, 100 U. S. 47; *Roberts* v. *Lewis*, 153 U. S. 367, 376. And see *Bauserman* v. *Blunt, supra*, overruling a decision of the Circuit Court antedating a conflicting decision of the state court. We are, therefore, constrained in the present case to accept the view of the state courts as announced by them without inquiring, as an original proposition, into the justice and sufficiency of the rule which we follow" (l. c. 463, 464).

Although there was a state statute and its interpretation involved in the case, it was the decisions of the state

court that were held by this Court to be determinative of the issues in the Federal court. At page 462, Mr. Justice Stone said:

> "Both the meaning of statutes of a State and the rules of the unwritten law of a State affecting property within the State are peculiarly questions of local law to be ascertained and established by the state courts" (l. c. 462).

The Kuhn case was a tort action, affecting real property. The case at bar is an action involving a right and interest in and to real property. There is a real difference between the cases. Conflict between state and Federal decisions is not quite as serious in tort actions, for there, principles of general common law are usually determinative and, by the very nature of the cases, forecast cannot be made with any certainty as to what result might be reached. But conflict between state law and Federal rules, as applied in the same state where rights and interest to real estate are involved, is especially undesirable because predictability is and has been of paramount consideration. That distinction makes the *Edward Hines Trustees* v. *Martin, supra,* case closer to the case at bar for there is a near connection between an action to remove a cloud on title to real estate and an action to cancel a lease, both of which are different than a tort action even though the tort affects realty.

In Smith Purifier Company v. *McGroarty,* 136 U. S. 237, 10 Sup. Ct. 1017, 34 L. Ed. 346, the action was in equity and it was held that a certain mortgage, having been held by the Supreme Court of Ohio to be invalid against general creditors, must be held invalid in the Federal court. Mr. Justice Gray said:

> "The present case is to be decided by the application of the law of Ohio to the facts stated in this bill and

> admitted by the demurer; and the best evidence of that law, as affecting the validity of the mortgages and assignment, is to be found in the decisions of the Supreme Court of Ohio."

In that case, it appears that the mortgage and assignment was made in 1885, and the state decision relied upon was rendered in 1889, or four years after the rights of the parties had accrued, but at a time prior to the action in the Federal court.

(c) *Sound reason dictates the necessity of following the rule of property established by state decisions.*

Swift v. *Tyson* expressly excepted from the operation of its doctrine state decisions affecting rights to things having a permanent location in the state, cases involving rights and interest in real property, and questions of local law. The extensions of that case have been many, but to extend it under the authority of the Kuhn case to the case at bar works a confusion and doubt as to just what rights the parties may have, instead of securing uniform rules of law.

In place of safeguarding a non-resident from discrimination in matters of title to real property, the decision of the Circuit Court of Appeals in this case subjects the resident to a discrimination. In *Smith Purifier Company* v. *McGroarty, supra,* the court said:

> "It would be an extraordinary result, if the courts of the United States, in exercising the jurisdiction conferred upon them with a view to secure the rights of citizens residing in different States, should hold such a conveyance to be valid against citizens of other States as the Supreme Court of Ohio holds to be void as against its own citizens."
>
> l. c. 241.

In *United States* v. *Cargill,* 258 Fed. 458, the court remarked:

> "For this court to refuse to follow the decisions of the Supreme Court of Arkansas would result in granting to noncitizens of the state, who can maintain action in the national courts, benefits not possessed by citizens of the state, and relief denied to the latter. This should be avoided, if at all possible."
>
> l. c. 466.

As pointed out by Judge McDermott, dissenting in the case at bar (R. 98, 103-104), the effect of the decision in this case gives to a non-resident lessee greater rights than a resident lessee possesses under an oil and gas lease within the state of Kansas. If the lessors had leased the premises to a resident lessee, there could be no question in this case but that the lease should have been cancelled. The decision of the trial court was according to Kansas law. A non-resident should have no just cause of complaint if his rights are measured by the same law as that of residents when he comes voluntarily into the state and acquires an interest in or a claim to real estate.

Mr. Justice Holmes has aptly stated the case for Federal courts following state decisions in questions of title and interest to real estate.

> "The title to real estate in general depends upon the statutes and decisions of the State within which it lies. I think it a thing to be regretted if, while in the great mass of cases the state courts finally determine who is the owner of land, how much he owns and what he conveys by his deed, the courts of the United States, when by accident and exception the same question comes before them, do not follow what for all ordinary purposes is the law." *Kuhn* v. *Fairmont Coal Co.*, 215 U. S. 349, at 370.

In this connection, Judge Caldwell, in *Hartford F. Insurance Company* v. *Chicago, M. & St. P. R. Co.*, 70 Fed. 201, states "As a result of these diverse rules of decision, each party to a suit engages in an unseemly struggle to get into

that jurisdiction whose rules of decision are believed to be most favorable to his side of the case."

It has also been pointed out that, if a state should enact a rule of general law into statute, it would be the duty of the Federal court to apply that statute. Because a state law is announced by a decision of court, it should have no less effect than when it is announced by statute. See dissenting opinion of Mr. Justice Holmes, *Black & White Taxicab Co.* v. *Brown & Yellow Taxicab Co.*, 276 U. S. 518, 48 Sup. Ct. 404, 72 L. Ed. 681.

The result of the decision in this case by the Circuit Court of Appeals causes extreme embarrassment in the field of real property rights, title and interest where predictability is especially important. It is impossible to determine one's rights until it is determined in which court the action is to be brought. In addition, predictability is further reduced because of the difficulty of forecasting with any degree of certainty whether the Federal court will regard the precise question one of local or general law. *Kuhn* v. *Fairmont Coal Company, supra. Smith Purifier Company v. McGroarty, supra. Edward Hines Trustees* v. *Martin, supra.*

2. *The Circuit Court of Appeals erred in holding that there was no breach of the implied covenant to explore and develop.*

The majority of the Circuit Court took the position that *Webb* v. *Croft, supra,* was Kansas authority in support of the principle applied by it from *Denker* v. *Mid-Continent Petr. Co., supra.* Although it is true that in the opinion in that case reasonable development was referred to as "drilling such number of wells as an ordinarily prudent operator would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the con-

tinuance of exploration and drilling, yet in applying that test as the measure, the court still adhered to the rule that there must be development, and held that it was grossly inequitable to hold a tract of 580 acres with but one producing well thereon. Applying the principle of what an operator of ordinary prudence would do, with due regard for the interests of the lessor, the Kansas decisions hereinbefore set out will not permit the lessee to hold an undeveloped tract for speculation, without any intention to develop it, gamble on the future at the expense of his lessor, and use geologic science to condemn the lease as a justification for his failure to develop it diligently as being worthless and yet refuse to back up that scientific information by surrendering the lease and letting someone else try it. Under the principles of the Kansas cases, such conduct does not square with "due regard for the interests of the lessor" and constitutes a breach of the implied obligation to explore and develop. These principles are forcefully stated by Judge McDermott in his dissenting opinion (R. 104-5).

Moreover, the Circuit Court erred in stating that there was no finding that the Petroleum corporation had breached the implied obligation to develop. The trial court found specifically:

> "I think the question of the defendant's diligence in exploring the premises is of paramount importance. I am compelled to conclude that the defendant has not shown that diligence in exploring and developing the land in question as is required under the law, equity and good conscience."

The fact that the surrounding and bordering land contains many producing wells, the expressed intention of the Petroleum corporation not to further develop it, the admission that the northwest corner of the undeveloped half section was not impossible of further development, that the lime strata under the undeveloped half section is at a

depth range of 570-610 feet below sea level in which range the record shows 60 producing wells on land either bordering on the undeveloped portion or in the apparent southwesterly-northeasterly "trend" and the two producing wells in the southwest corner of the lease involved furnish ample evidence to support the finding of the trial court. Consequently, in its zeal to exercise its independent judgment in the face of an established rule of state property law, the Circuit Court failed not only to recognize the breach of the implied covenant but overruled the specific finding of the trial court, in support of which the record contains ample evidence.

Believing that in a suit to cancel an oil and gas lease, the implied obligation to explore and develop presents a rule of property law the decisions with reference to which should be binding upon the Federal courts, and that the Circuit Court of Appeals has both failed to follow Kansas decisions therein and to properly interpret and apply them, your petitioners earnestly submit that the United States Circuit Court of Appeals, Tenth Circuit, committed prejudicial error in its ruling in the matters hereinabove discussed, and that in view of the questions involved to the rights of your petitioners, and the fair and clear administration of justice, this Court should issue its writ to review and decide these questions.

Respectfully submitted,

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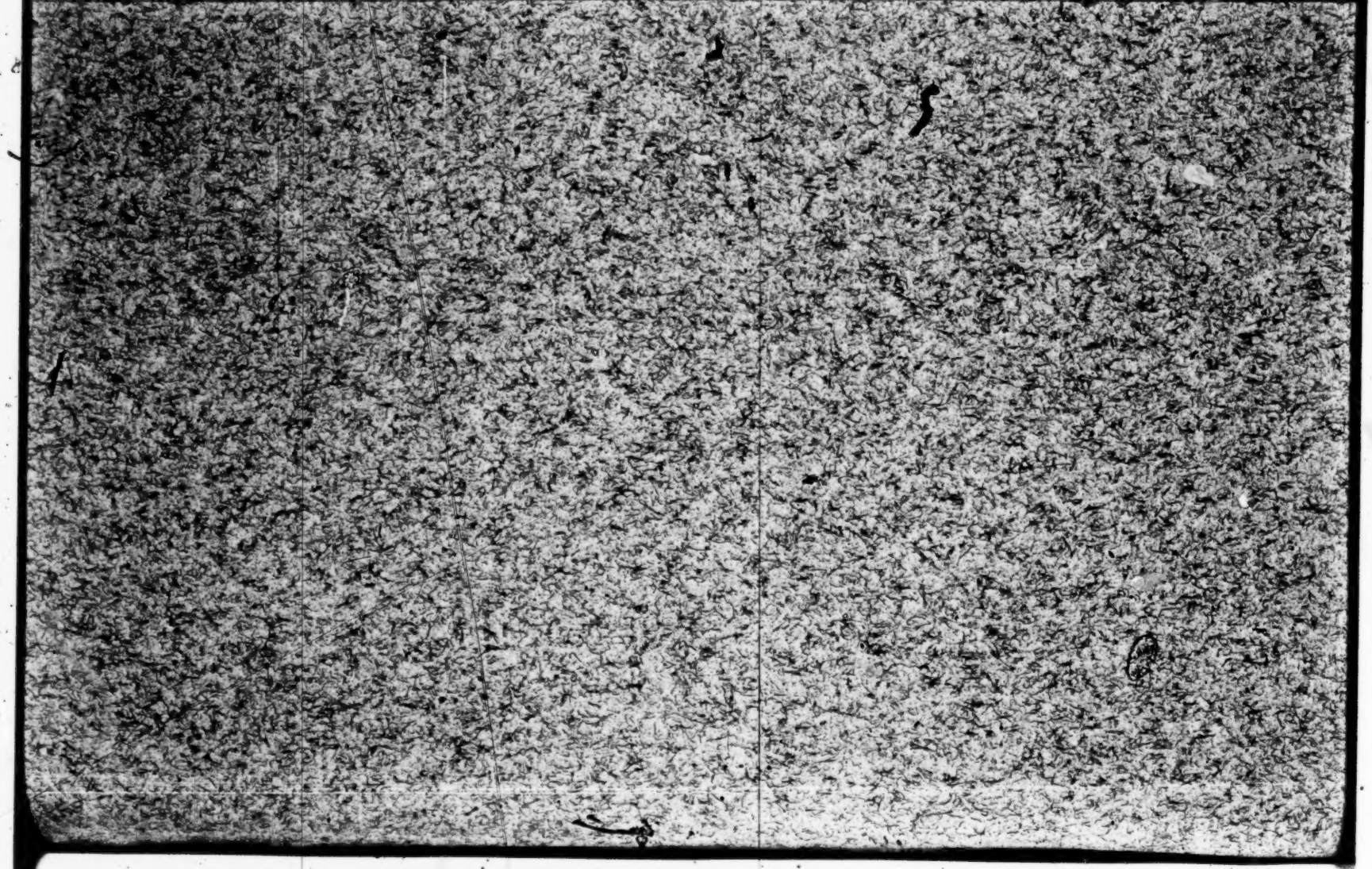

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933.

No. 660.

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL., *Petitioners,*

VS.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

BRIEF OF PETITIONERS ON THE MERITS ON WRIT OF CERTIORARI.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933.

No. 660.

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL., *Petitioners,*

VS.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

BRIEF OF PETITIONERS ON THE MERITS ON WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURT BELOW.

The opinion of the United States Circuit Court of Appeals, Tenth Circuit (R. 84), sought to be reviewed is reported as *Mid-Continent Petroleum Corpordtion* v. *Sauder et al.*, 67 F. (2d) 9; the dissenting opinion of Circuit Judge McDermott, at page 13 (R. 90). Petition for certiorari was filed on December 15, and certiorari granted January 24, 1934.

II.
JURISDICTION.

1. The date of the decree to be reviewed is September 14, 1933 (R. 99);

2. The petitioners here were the appellees in the Circuit Court of Appeals. The claims advanced and rulings made by the Circuit Court of Appeals, here relied upon as the basis of this court's jurisdiction, are, as follows:

(a) The Circuit Court of Appeals erred in refusing to follow and apply the Kansas decisions to the effect that the implied covenant in an oil and gas lease to fairly exhaust the capability of land to produce mineral, requires that developing be done by drilling, and that if the land will not produce minerals or the lessee is not justified in drilling, he cannot continue to hold it by virtue of a provision extending the lease term so long as oil or gas be produced in paying quantities; and thus has:

(1) Departed from the accepted and usual course of judicial proceedings and created a conflict of decisions between the various Circuit Courts of Appeal;

(2) Decided an important question in a way probably untenable and in conflict with the weight of authority and of the principles announced by this court;

(3) Brought about a situation where diverse citizenship, instead of preventing a discrimination against a non-citizen, results in a discrimination in his favor and against the citizen, and, instead of making one law for all in a state, makes different laws for a citizen and a non-citizen, thus making a bewildering confusion which has incited a demand to abolish Federal jurisdiction based on diverse citizenship;

3. The jurisdiction of this court is invoked under Sec. 240 of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U. S. C. A. 347);

4. The cases believed to support the jurisdiction of this court are:

Edward Hines Trustees v. *Martin,* 268 U. S. 458, 45 Sup. Ct. Rep. 543, 69 L. Ed. 1050.

Black & W. Taxicab Co. v. *Brown and Y. Taxicab Co.*, 276 U. S. 518, 48 Sup. Ct. Rep. 404, 72 L. Ed. 681.

Guffey v. *Smith,* 237 U. S. 101, 35 Sup. Ct. Rep. 526, 59 L. Ed. 856.

Hartford Ins. Co. v. *Railway,* 175 U. S. 91, 20 Sup. Ct. Rep. 33, 44 L. Ed. 84, 89.

III.

STATEMENT OF THE CASE.

The petitioners are the heirs at law of Philip Sauder, who brought this suit to cancel the undeveloped portion of an oil and gas lease on 360 acres of land located in Greenwood County, Kansas (E ½; and SE ¼ SW ¼, Sec. 16, Twp. 23 South, Range 13 East), for failure to explore and develop, which lease, by mesne assignments, had passed to the respondent, Mid-Continent Petroleum Corporation, a Delaware corporation (R. 15-20).

The trial court entered a decree canceling said lease except as to a tract 860 feet east and west and 400 feet north and south located in the SE ¼ SW ¼, on which two producing wells had been drilled (R. 42-3). On appeal, the United States Circuit Court of Appeals, Tenth Circuit, reversed said decree without

prejudice to the bringing of a new suit in the event changed conditions should indicate a breach of the implied covenant to develop. The majority opinion by Circuit Judge Phillips is found at R. 84-90, and the dissenting opinion by Circuit Judge McDermott at R. 90-8.

The lease, dated June 6, 1916, for the consideration of $1.00, granted to the respondent's predecessors in interest,

> "The exclusive right * * * to enter upon, operate for and procure oil and gas, * * * *for 10 years from date * * * and as long thereafter as oil and gas can be procured thereon in paying quantities,*"

on 360 acres of land described, as follows:

> East Half (½) of Sec. 16, Twp. 23, R. 13, acres 320; Southeast ¼ of Southwest ¼ Sec. 16, Twp. 23, R. 13, Acres 40.

The lessors were to receive:

(a) One-eighth of the oil realized from the premises in tanks or the market price in cash;

(b) On demand sufficient gas for domestic purposes (if sufficient gas is found in any well or wells producing gas only to justify the expense of saving and casing same);

(c) $100.00 per year for and during such time as gas shall be sold or marketed (if lessee shall market or sell gas from any well producing gas only);

Lessee (respondent) was to receive:

(a) Free gas or oil for drilling or operating all machinery;

(b) The remainder of all of the gas;

(c) Privilege of using sufficient water from any creek, branch, lake, or pond on the premises; if neces-

sary to drill therefor or make ponds, to run all necessary machinery for drilling and prospecting for oil and gas and operating same;

(d) Exclusive right to erect, lay, and maintain upon the premises, all pipe, pipe lines, machinery, and structures necessary for the production, preservation or transportation of oil and gas or to remove the same;

(e) The right to discharge any incumbrance on the premises and have a lien for the amount so paid and necessary costs and expenses" (R. 6-8).

With reference to the commencement of drilling, the lease provides that:

> "In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. Provided, however, that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance" (R. 7).

The lease further provided that:

> "If Oil or Gas be found on these premises by said second parties, all rights, benefits, and obligations secured hereby shall continue so long as either can be procured in paying quantities" (R. 6-7).
>
> "This Contract Shall extend to and be binding upon the heirs, assigns, successors and personal representatives of the parties hereto. Executed in duplicate the day and year first above written" (R. 8).

On November 1, 1921, and January 1, 1922, during the primary term of the lease, predecessors of the respondent completed two wells in the SE ¼ SW ¼ Sec. 16, which have ever since produced, and now produce, oil in paying quantities. Each of these was an offset well to producing wells located in the NW ¼ of Sec. 21 and the SW ¼ of Sec. 16 (R. 23). There has been no further drilling on the Sauder lease during the 17 years since its execution (R. 21, 33-4, 48, 53; Exh. 1, R. 66-A, 22). Seven-eighths of the total revenue, which accrued to the operator from the Sauder lease up to December 31, 1931, was $72,694.18; the total expenditures for drilling, equipping and operating were $46,464.97; leaving a profit to respondent of $26,229.21 and an average rate of earning on the basis of expenditures of 5.1 per cent per annum (R. 48). It cost $15,000.00 to $16,000.00 to drill and equip each well (R. 48). Reference will be made in the argument to show the fallacy of this testimony with reference to the rate of return. The lessors have received between $9,000.00 and $10,000.00, a part of the payments being, as follows:

1927	$760.50
1928	658.45
1929	623.90
1930	495.43
1931	239.23
1932	258.00

The petitioners' evidence proved the location, date of drilling, depth and initial production of the wells drilled on land bordering upon the land involved. It showed, and the court found, producing wells, as follows:

To the North and East—in the SW ¼ of Sec. 10—16 wells; *To the East*—in the half section lying immediately east of the half section involved, being W ½ of Sec. 15—25 wells; *To the Southeast*—in the NW ¼ of Sec. 22—12 wells; *To the South*—on the half section lying immediately south of the land in question, being N ½ of Sec. 21—10 wells; *To the Southwest*—in the NE ¼ of Sec. 20—6 wells; To the West—in the SW ¼ of Sec. 16 and the SE ¼ of Sec. 17—7 wells. There are also two other scattered wells to the West and two to the North of the land in question. None of these wells is within 400 feet of the land in question except those to which the two wells in the SW ¼ of Sec. 16 are offsets. They are within 200 feet south and west thereof (Exh. 1, R. 66-A, 34).

Defendant's Exhibit E (R. 72-A) also shows these additional producing wells: 10 in the SE ¼ of Sec. 10; 18 in the East half of Sec. 15; 5 in the NE ¼ of Sec. 22; 11 in the South half of Sec. 21; and approximately 40 in a southwesterly "trend" from the Sauder lease in Sections 20, 29 and 32. The East half of the Sauder lease is the only tract in a "trend" running northeasterly and southwesterly for a distance of 5 miles which does not have oil production (R. 56-8, 66-A). Of the 22 wells drilled on the land adjacent to the Sauder lease on the Southwest, two were drilled prior to the Sauder Number One. Of the 13 wells on the land adjacent to the Southeast, one was drilled prior to Sauder Number One. Of the 25 wells on the land adjacent on the half section East, none was drilled prior to Sauder Number One. Of the 20 wells drilled on the land adjacent on the Northeast,

one was drilled prior to Sauder Number One (Plff. Exh. 1, R. 66-A).

The respondent owns and is operating the SW ¼ of Sec. 15, lying East of the land in question, containing thereon 9 producing wells; also the NW ¼ of Sec. 22, lying Southeast of the land in question, with 12 producing wells thereon, and the North half of Sec. 21, lying immediately South of the land in question, with 9 producing wells thereon (Exh. 1, R. 66-A).

The wells to the East of the Sauder lease are producing from the Bartlesville sand and Mississippi lime, the major portion being from the Bartlesville sand which is found in long, narrow strips averaging about 3 well locations (a width of 460 feet per location) (R. 49, 55). The best wells were had by drilling in the middle or crest of this sand and the locations to the West toward the East side of the Sauder lease, or to the East in the opposite direction, showed the sand to be thinner with more water and less oil (R. 50, 51, 55, 60).

The wells on the Sauder lease and those to the South, West, and Southwest, are producing from the Mississippi lime, which underlies the Bartlesville sand (R. 51, 55, 59, 60-3, and 64). A geologist, who had never been on the lease involved, gave as his opinion that there was an absence of oil in paying quantities in the Mississippi lime underlying the Sauder lease, for the following reasons: (1) "Said lime formation produces oil at a higher point and is barren of oil at its lower points; that is, the oil is found where the lime is near the surface (R. 61-2); (2) The formation dipped in every direction except from the Northwest to the Southwest (R.

61); (3) Wells encountered in the lime at a greater depth than 570 feet below sea level in the vicinity of the Sauder lease were usually dry holes or produced oil in negligible quantities (R. 60-1; Exh. E, R. 72-A); (4) Three dry holes were drilled near the Sauder lease, one in the SE ¼ of Sec. 9, 1,880 feet North of the North line and 200 feet West of the East line extended of the Sauder lease; one in the NW ¼ of Sec. 16, 630 feet West of the West line and 290 feet North of the West line of the Sauder lease, and 290 feet North of the center line of Sec. 16; another in the SW ¼ of Sec. 16, 200 feet West of the West line and a thousand feet North of the South line of the lease; and a well in the SW ¼ of Sec. 15, 750 feet East of the East line of the Sauder lease did not produce oil in paying quantities. The two wells drilled in the Sauder lease reached the lime at 558 and 574 feet respectively (R. 50-1, 56, 72-A, Exh. E). Some of the wells to the Northeast are producing from the Bartlesville sand and some from Mississippi lime (R. 59).

The lime under the Sauder 320 acres is from 570 to 610 feet below sea level and much of the South half is between 570 and 590 feet below sea level (R. 72-A, Exh. E). In the section adjoining on the Southwest (E ½ of Sec. 20 and W ½ of Sec. 21) there are 23 producing wells where the lime is between 570 and 610 feet and 9 wells higher than 570 feet. In Sec. 29, lying next farther Southwest, there are 20 producing wells between the 570-610 feet range and in the field adjoining on the Northeast there are 17 producing wells within the 570-610 feet range and 3 higher than 610 feet. There

are dry holes between 590 and 610, but there are also dry holes as high as 564 feet (Exh. E, R. 72-A).

The respondent, defendant below, introduced opinion evidence of its Vice-President in charge of production, its District Superintendent in charge of production, a geologist in its employ, and the Superintendent of another drilling company to the effect that, taking into consideration the development both on the lease and surrounding leases, the cost of drilling and equipping a well, and the probability of encountering paying production and other available facts, that no prudent operator would have drilled another well on the Sauder lease (R. 51, 55, 61, 65). The Vice-President testified that the dry hole at Theta well No. 2, located 1,880 feet North of the North line of the Sauder lease, and the small production at Viola M. Griblin "B," No. 1, 760 feet South of the South line of said lease, tended to prove that oil did not exist in paying quantities under the Sauder lease (R. 50). On the question of drainage, the testimony was that no wells around the lease involved on adjoining properties would be called "offset wells" (Moody, R. 55) and Snyder, respondent's district superintendent, "did not think" that the wells around the lease involved that had been pumping from 8 to 11 years, were draining oil from under the Sauder lease (R. 58). Generally these witnesses testified as to their opinion founded on practical experience and watching developments, but stated that their theories might be wrong; that they did not want to tell the court that they could tell where there was oil; and that if a well had been drilled in the middle of the lease involved, information could have been se-

cured which was not now possessed and such information might change the facts upon which their theories and conclusions were based; and that the only way to be absolutely certain as to whether there was any oil in the lime under the involved half section was by drilling a well (R. 54, 56-7, 62-3); that oil had been produced in Greenwood County for years (R. 58).

The respondent's evidence also showed that the half section in question was worthless from the standpoint of future development (Moody, R. 52), but Geologist Young testified that he would not say that the half section was undoubtedly worthless from an oil standpoint (R. 62); that if it were later developed that production could be obtained, the defendant would be willing to develop it; but the purpose of the defendant was to hold the lease without any further development, or until somebody else developed something or until it gained information itself, but it had no immediate intention of developing the lease involved; and that its geological record showed that the Northwest corner of the lease had not been developed as thoroughly as around the edges of it, and that it was not impossible of further development in the Northwest corner (R. 52-3).

On June 16, 1926, Sauder wrote a letter to the defendant, in substance calling attention to the expiration of the 10 year term of the lease; that respondent was supposed to operate, and in effect demanding that respondent explore and develop or in the alternative release its claim to the land except upon that part upon which the two wells had been drilled and were producing oil. On June 25, 1926, respondent replied by letter stat-

ing that, in substance, it considered the lease a valuable one and would not surrender it.

The trial court made findings of fact on all material questions, including a general finding of each and all other issues of fact involved in favor of the plaintiffs and against the defendant (R. 33-36). The findings on matters as to which there is a specific controversy being as follows:

A. None of the oil wells referred to in the above finding are within four hundred feet of the property line of the land described in the lease with the exception of wells to the south which have been offset by the two wells drilled upon this property. The defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from the plaintiff's land. These witnesses, however, admitted that they might be mistaken as there was no absolute way of determining the question of drainage except by drilling tests. This evidence as to drainage is not wholly convincing to the court. There is, in the opinion of the court, some probability that damage is being done to this leasehold by drainage upon the adjoining properties (R. 34);

B. On the basis of the oil development and oil production upon adjacent lands, as shown by the evidence herein, plaintiffs contend that a well-defined "trend" of oil producing sand and lime runs in a southwesterly-northeasterly direction under and across the land described in said lease. Expert evidence introduced by the defendant tended to prove that no such "trend" exists under and across the land described in said lease, but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said

land, as estimated by geologists, is so great that the probabilities are no oil would be found in it. On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of Section Sixteen (16) but no dry well has been drilled on any of the property covered by said lease (R. 35);

C. On the 16th day of June, 1926, Philip Sauder, then the owner of the land described in said lease, wrote a letter to the defendant in substance, calling the attention of the defendant to the expiration of the ten year term of said lease, and that no wells had been drilled except the two wells heretofore mentioned and demanding that the defendant proceed to explore and develop said land by the drilling of additional wells, or in the alternative that the defendant "release" its claim to all of said land except that part upon which the two wells had been drilled and were producing oil. On June 25, 1926, the said defendant replied to said letter from Philip Sauder, in which letter it stated, in substance, that it considered said lease a valuable one and would not surrender the same (R. 35-6);

D. No effort has been made by the defendant since said letters toward exploration or development by the drilling of wells or otherwise and the evidence in this case shows that the defendant and its officers and employees have no present intention of further exploring or developing said lease and no intention ever to further develop said lease unless and until further developments in the im-

mediate vicinity thereof might convince said defendant and its officers and agents that it would pay the defendant to further explore or develop said lease (R. 36);

E. Evidence of the defendant tends to show that the land covered by the lease in the instant case is worthless for oil drilling purposes (R. 36);

After stating that,

> "If the lease is worthless, as contended by the defendant, it is neither equitable nor just to permit the defendant to continue to hold the lease except upon the 10 acres where the two offset wells are located" (R. 36),

and,

> "I think the question of the defendant's diligence in exploring the premises is of paramount importance" (R. 37),

and,

> "I am compelled to conclude that the defendant in the instant case has not shown that diligence *and* (in) exploring and developing the land in question as is required under the law, equity and good conscience" (R. 39),

the court concluded as a matter of law that:

1. Under the facts and circumstances in this case, as shown by the evidence and the record, the plaintiffs have no adequate remedy at law;
2. The defendant and its predecessors in title have not in good faith and with reasonable diligence explored and developed the lands described in this lease in accordance with the express and implied covenants of said lease;
3. It would be inequitable and unjust to permit the defendant to hold, keep, and retain the leasehold property involved herein without further explora-

tion or development, as said defendant proposes to do, as shown in the pleadings and evidence herein;

4. The plaintiffs, under the evidence, are entitled to a judgment of this court canceling said lease as to all the land described therein except the southwest quarter of the southeast quarter of the southwest quarter of said section Sixteen (16) upon which the two offset wells heretofore mentioned were drilled and developed by defendant or its predecessors in title;

5. The defendant is entitled to hold and enjoy its leasehold rights upon said ten acres of land described in Conclusions of Law No. 4 herein so long as it produces gas or oil therefrom in paying quantities;

6. I find each and all of the other issues of law involved herein in favor of the plaintiffs and against the defendant, to all of which findings and conclusions and each and every part thereof the defendant objects and excepts and its exceptions are allowed (R. 39-40).

The Circuit Court of Appeals held that there was an implied covenant on the part of the lessee to drill such wells as under the circumstances an operator of ordinary prudence, having regard for the interests of both lessor and lessee, would drill; that the trial court did not find that the Petroleum Corporation had breached such implied obligations and that such a finding would have been wholly without support from the evidence (R. 88-9).

The Supreme Court of Kansas, in *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500 (decided June 12, 1926), had applied a different measure of diligence to the implied

covenant to develop. There it held that a lessee could not hold a lease on 160 acres by drilling a single producing well, that there was an implied covenant fairly to exhaust the capabilities of the land and produce the minerals, and that if the undeveloped part will not produce minerals in paying quantities, and the lessee is not justified in drilling more wells, he cannot continue to hold by virtue of a provision in the lease extending the term to so long as oil or gas be produced in paying quantities (R. 89).

The majority opinion held that the trial court's decision was predicated on *McCarney* v. *Freel* (*supra*) conceded by counsel to support the trial court, distinguished it from the case at bar because there the decree was predicated on a breach of the implied covenant whereas there was no breach in the instant case and further held that since *McCarney* v. *Freel* (*supra*) was decided long after the Sauder lease was entered into, that that opinion was not binding upon the Federal courts and, as that court could not subscribe to the doctrine of *McCarney* v. *Freel* because it imposed a greater obligation under the implied covenant to develop than is recognized by the great weight of authority or placed an obligation on the lessee not imposed by the lease contract, it would exercise its own independent judgment as a court of equity. It therefore followed and applied the principles announced by it in *Denker* v. *Mid-Continent Petr. Corp.*, (C. C. A. 10) 56 F. (2d) 725, a case decided in 1932 and involving an oil and gas lease on Oklahoma land (R. 89-90).

Circuit Judge McDermott, dissenting, held that the rights of a holder of an oil and gas lease constitute rules of property to be governed by decisions of the Kansas court; reviewed the Kansas cases both prior and subsequent to the execution of the Sauder lease, and held that *McCarney* v. *Freel* did not overturn any settled rule of property law in Kansas, but is in accord with the current of Kansas authority (R. 91-2), and that either before or after 1916, the date of the Sauder lease, the Kansas court would not permit a lessee to hold 320 acres of land for 17 years without exploration or development and that the Federal Court should apply the Kansas law and cancel the undeveloped part of the lease (R. 94-6); that if he were wrong in his construction of the earlier Kansas decisions, the question was at least an open one at the time the interest in the real estate was acquired, and in that event the rights of the parties should be governed by the later decisions of the Kansas courts in 1918 and 1926 rather than by the later decision of the Federal Court in 1932; that if the lessee of the Sauder lease were a resident of Kansas, the lessor would be entitled to cancellation, and that the majority was permitting a non-resident corporation to acquire a greater interest in Kansas real estate than a resident might acquire (R. 96).

Circuit Judge McDermott further held that if the Kansas decisions are to be ignored the same result should obtain, because a prudent operator, having regard for the interests of the lessor as well as his own, ought not to hold 320 acres almost surrounded by oil wells, without drilling a test well, and that in common fairness he

ought to give the lessors a well or get off and let someone else drill it; that tying up a half section of land for 17 years without drilling a single exploratory well, and with no hope of one unless some other operator drills on adjoining land, does not square with "due regard for the interest of the lessor" and constitutes a breach of the implied covenant diligently to explore and develop (R. 97-8).

IV.

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in refusing to follow the Kansas decisions which established the obligation of a lessee under an oil and gas lease to explore and develop (R. 84-90).

2. The Circuit Court of Appeals erred in holding that there was no breach of the implied covenant to explore and develop (R. 84-90).

V.

ARGUMENT.

A. The Circuit Court of Appeals Erred in Refusing to Follow the Kansas Decisions Which Had Established the Obligation of the Lessee Under an Oil and Gas Lease to Explore and Develop.

1. An oil and gas lease in Kansas grants such an interest in real estate as to have a permanent location.

Although an oil and gas lease must be interpreted in the light of its own provisions (*Gas Co.* v. *Neosho County*, 85 Kan. 335, 89 Pac. 750; *White* v. *Green*, 103

Kan. 405, 173 Pac. 974) the Kansas Supreme Court held in *Haggard* v. *Wheeler*, 116 Kan. 702, 229 Pac. 357, that an oil and gas lease, similar to the lease in the case at bar, was such an estate or interest in land as to be the subject of a suit to quiet title under a Kansas statute, which provides:

> "Action may be brought by any person in possession by himself or tenant of real property, against any person who claims an estate or interest therein, adverse to him, for the purpose of determining such adverse estate or interest (R. S. 1923, 60-1801)."

The form of action was questioned and the argument made that the action was in substance one to cancel the lease, but it was the holding of the court that the lease was such an estate or interest in the land that a suit to quiet title was proper when leveled against the lease.

In *Strickler* v. *Stanford*, 109 Kan. 43, 197 Pac. 866, it is said:

> "It is settled in this state that a lease conveying the oil, gas and minerals found in and under lands, together with the right to enter upon the land and remove the same, is a conveyance of a part of the realty. (*Zinc Co.* v. *Freeman*, 68 Kan. 691, 75 Pac. 995, and cases cited in the opinion.)" (l. c. 45.)

In *Brinkman* v. *Empire Gas and Fuel Company*, 120 Kan. 602, 245 Pac. 107, the interest granted by an oil and gas lease was stated to be a *profit a' pendre*, which is very definite interest in and touching upon real estate.

By statute an oil and gas lease in Kansas, is such an interest as to support a contractor's lien for labor or material (R. S. 1923, 55-207).

In *Derby Oil Company* v. *Bell,* 134 Kan. 489, 7 Pac. (2d) 39, it was held that an ordinary oil and gas lease is a conveyance of such an interest in real property as to come within the provisions of the real property recording act, which provides:

> "Every instrument in writing that conveys real estate or whereby any real estate may be affected, proved or acknowledged, and certified in the manner hereinbefore prescribed, may be recorded in the office of the Register of Deeds of the County in which such real estate is situated. * * *" (R. S. 1923, 67-221.)

It has also been held that the right transferred by an oil and gas lease constitutes an alienation of a homestead and that the consent of a husband and wife is necessary to its validity. *Palmer* v. *Parrish,* 61 Kan. 311, 59 Pac. 640; *Thomas* v. *Milliken,* 93 Kan. 72, 143 Pac. 430. The interest created by such a lease has also been defined as incorporeal hereditament, *Robinson* v. *Smalley,* 102 Kan. 842, 171 Pac. 1155.

A very enlightening discussion of just what interest or right is created by an oil and gas lease is contained in the opinion by Chief Justice Johnson in *White* v. *Green,* 103 Kan. 405, 173 Pac. 974, where, after distinguishing between leases which conveyed the title to, or mineral contained in, the land and a mere license to explore, it was said:

> "Although the right granted herein may not have accomplished a severance of the mineral, nor arise to the dignity of what is termed an estate in land, it did give the lessee an exclusive and assignable right to the use of a portion of the land for a period of at least five years. With it went the right to

> use so much of the surface for laying pipe lines, erecting buildings, tanks, stations, and other structures as was necessary to accommodate the oil and gas taken from the wells which the lessee contracted to drill. Thus the lessee has, not only the right to drill for mineral, but he has the absolute right to possession of a part of the land on which to care for the mineral produced. This is a right which no one can take from him during the period of the lease if the required conditions are performed. As will be observed, the provisions of the grant were extended, not only to the heirs and assigns of the lessee, but also to those of the lessor. While the lease may not have given title to the mineral in the land, it did give something in connection with the land which was capable of being inherited. In a number of cited cases it has been designated as an incorporeal hereditament. It is a grant in the nature of an easement, and it is something which may be inherited, and which the law and good public policy require shall be committed to writing * * *"

Since *Swift* v. *Tyson*, 16 Peters 1, 10 L. Ed. 865, where by specific language the binding effect of state law was recognized as to "rights and titles to things having a permanent location, such as rights and titles to real estate, and other matters movable and intra-territorial in their nature and character," and through later decisions of this court, those matters affecting rights and interests to, or essentially touching upon real estate or matters local in nature, have been controlled by state law.

From the Kansas cases cited above, it is easily observed that while an oil and gas lease may not convey what is technically described as an estate in land, it does grant to the lessee a right and an interest in land, sometimes called an incorporeal hereditament, or a

profit a' pendre. It creates such an interest and right as to have a connection with and become a part of, the realty. It has a definite and fixed location, "immovable and intraterritorial in its nature and character."

In *Thurlow* v. *Waite-Phillips Oil Co.* (C. C. A. 8), 22 F. (2d) 781 (1927), the court held that an oil and gas lease involved title to real estate in Kansas, and it was bound to follow the state decisions even though a Federal court disagreed with the local law (785); and in *Harrell* v. *United Carbon Co.* (C. C. A. 5), 52 F. (2d) 790, an action to cancel an oil and gas lease on land in Louisiana, where no well had been drilled within the five year primary period, the Court held that it was bound by a decision of the Louisiana Supreme Court upholding the contention of the appellant, even though it was rendered after the cause was argued in the Circuit Court of Appeals. The Sauder lease in question, giving the respondent the right to explore for oil and gas, the right to possession for those purposes, being perpetual in character under its terms, and extending to and binding the heirs, assigns, successors, and personal representatives of the parties, comes squarely within the principles announced by the foregoing authorities.

2. The Kansas decisions with reference to the obligation to explore and develop, constitute rules of property, are binding on the Federal Court and should be followed by it.

Since the rights and interests created by an oil and gas lease in Kansas constitute rules of property local in nature, touching upon and a part of realty, and possess-

ing a permanent location, the laws of Kansas as announced by the line of Kansas decisions hereinafter stated and analyzed in section A-3 of this brief, should have been followed by the Circuit Court of Appeals as binding upon its decision in this case.

Swift v. *Tyson,* 16 Peters (U. S.) 1, (1842), 10 L. Ed. 865 (Note 1), is the fountain-head of the law relating to the binding effect of state decisions in Federal courts. In announcing the doctrine of that case, Mr. Justice Story exempted from its application and left under the binding effect of state decisions, rights and titles to things having a permanent location "and other matters immovable and intraterritorial in their nature and character" (l. c. 18). That case further excepted the field of law governed by rules of a local nature, and not predicated upon general common law.

That local rules of property are binding on the Federal courts is amply sustained by the following cases: *Warburton* v. *White,* 176 U. S. 484, 20 Sup. Ct. Rep. 404, 44 L. Ed. 555; *Abraham* v. *Casey;* 179 U. S. 210, 218, 21 Sup. Ct. 88, 45 L. Ed. 156; *Walker* v. *State Harbor Commission,* 87 Wall. 648; *Barrett* v. *Holmes,* 102 U. S. 651,

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Note 1: Since that time the subject has been one of much comment and extensive litigation: **Warren, History of Federal Judiciary Act of 1789, 37 Harvard Law Review, 49; Pepper, The Border Line of Federal and State Decisions; William Trickett, The Non-Federal Law Administered in Federal Courts, 40 Am. L. Rev. 819; Frankfurter, Distribution of Judicial Power between United States and State Courts, 13 Cornell Law Quarterly, 499; Sharp and Brennan, The Application of the Doctrine of Swift v. Tyson since 1900, 4 Indiana Law Journal 367; Meigs, Decisions of the Federal Courts on Questions of State Law, 45 Am. L. Rev. 47; 1 Beale, Conflict of Laws (1916) Sec. 112a; Dobie, Federal Procedure (1928) Sec. 142; Note 40 L. R. A. (N. S.) 380; Note 71 A. L. R. 1102; Note 57 A. L. R. 435.**

26 L. Ed. 291; *Bucher* v. *Cheshire Rwy.*, 125 U. S. 555, 8 Sup. Ct. 974, 31 L. Ed. 795; *East Central Eureka Company* v. *Central Eureka Company*, 204 U. S. 266, 27 Sup. Ct. 258, 51 L. Ed. 476; *Hartford F. Ins. Co.* v. *Chicago, M. & St. Paul R. Co.*, 175 U. S. 91, 44 L. Ed. 84, 89, 20 Sup. Ct. Rep. 33; *Brine* v. *Ins. Co.*, 96 U. S. 627, 24 L. Ed. 858. A Federal court was held bound by Kansas state decisions as to whether an oil and gas lease of riparian land carries the right to drill in land formed by accretion. *Thurlow* v. *Waite-Phillips Oil Co.* (C. C. A. 8), 22 F. (2d) 781, certiorari denied 278 U. S. 598, 49 Sup. Ct. 8, 73 L. Ed. 528, and the decision of the state court upon a question peculiar to mining leases was followed in *Foster* v. *Elk Fork Oil & Gas Company*, 32 C. C. A. 560, 90 Fed. 178.

The exception to *Swift* v. *Tyson* has been extended to include questions relating to rights in personal property.

Dooley v. *Pease*, 180 U. S. 126, 21 Sup. Ct. 329, 45 L. Ed. 457.

Bryant v. *Swofford Co.*, 214 U. S. 279, 29 Sup. Ct. 614, 53 L. Ed. 997.

In *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. Ed. 856, a case in equity, it was held where an oil and gas lease under the decisions of Illinois state court constituted an interest in realty, that the decisions of the highest courts of the state in which the property is situated are accepted and applied by the Federal courts as rules of property.

It should be observed that it is the rule of this court that "the construction and effect of a conveyance be-

tween private parties is a matter as to which we follow the court of the state." *East Central Eureka Company* v. *Eureka Co., supra,* l. c. 272. That is a principle announced by this court as early as *McGoon* v. *Scales,* 9 Wall. 23, followed in *Brine* v. *Ins. Co., supra,* and applied in *American Brake Shoe Company* v. *New York Ry. Co.,* 278 Fed. 842 (1922), as to construction of a lease.

Judge Phillips, writing for the majority in the case at bar (R. 91), prefers to disregard the Kansas rule because three of the cases (*Alford* v. *Dennis, Webb* v. *Croft, McCarney* v. *Freel; infra*) were decided after the lease between the parties was made (R. 96). That position was sought to be justified by the authority of *Kuhn* v. *Fairmont Coal Company,* 215 U. S. 349, 30 Sup. Ct. 140, 54 L. Ed. 228.

It is to be noted that in the case at bar there was a line of Kansas cases in existence before the lease was made, all of which established the Kansas rule contended for. In addition, there were two cases decided immediately after the lease was made, the language of which was very much in point, followed by the *McCarney* v. *Freel* case, all of which were decided from 14 to 6 years before *Denker* v. *Mid-Continent Petr. Corp.,* 56 F. (2d) 725, 84 A. L. R. 756, which is principally relied upon by the Circuit Court of Appeals in reaching its result in this case. The Denker case arose from the District Court of Oklahoma, and it is a fair inference that the trial court was applying Oklahoma law, and the citation of authorities in opinion of the Circuit Court convinces that it was likewise applying Oklahoma law. It cannot be the purpose of the Kuhn case to impose upon resi-

dents of Kansas the rule of property of Oklahoma, adopted by the Federal Circuit Court of Appeals, in a case arising from that state.

The Denker case was decided two years after the case at bar was filed, and sixteen years after the instant lease was made. Thus, while in the case at bar the line of state decisions commenced before the lease was made, and continued after its execution, all the decisions were made a considerable time before the case at bar was filed.

The question certified in the Kuhn case was whether a single state decision, decided after the Federal action was brought, was decisive in an action in the Federal court (215 U. S. at 356). It was held that the state decision did not bind the Federal court, which could decide the question according to its own law, but having regard for the state decision. Three Justices dissented from the doctrine and the result reached in that case.

In the Kuhn case, there was only a single state decision ruling on the proposition of law, and that made after the action in the Federal court had commenced. The rule of applying the state law in the Federal courts, where property rights are involved, has required that the state law be an established rule of property. The Federal courts hesitate to follow a single or individual decision of the state courts, and prefer to follow a line of decisions establishing a rule. *Lane* v. *Vick*, 3 How. 464, 11 L. Ed. 681; *Chesko* v. *Delaware & H. Company*, 218 F. 804; *Pineland Club* v. *Robert* (C. C. A. 4) 213 F. 545, 556; *Lewis* v. *Atwood*, 228 F. 753.

It is a great distance from Kuhn vs. Coal Company to the case at bar, and it must first pass the hurdle of the unanimous decision of this court in *Edward Hines Trustees* v. *Martin,* 268 U. S. 458 (1925), 45 Sup. Ct. 543, 69 L. Ed. 1050, which was apparently not considered by the Circuit Court of Appeals. That case was an *equitable* action to remove a cloud on title to some real estate, and it was held that repeated decisions of the state courts, establishing a rule of property in the state, will be followed by the Federal courts without inquiry into the correctness of the rule as an original question.

In that case, the petitioners' title depended upon a patent issued June 27, 1871, and the defendant's title was acquired through a second patent of December 7, 1883, both patents being issued by the State of Mississippi. *Thereafter,* by cases decided in 1888, 1917, and two cases in 1924, the Supreme Court of Mississippi made decisions determining the law governing the rights and title to land proceeding from patents and situations similar to the Hines case. Mr. Justice Stone, writing for this court, said:

> "But where the rule is one affecting title to real estate within the State and has been repeatedly determined by decisions of state courts so that it is established as the law of the State, there has been no departure from the rule that the federal courts will follow the decisions of the state courts. *Jackson ex dem St. John* v. *Chew, supra; Green* v. *Neal,* 6 Pet. 291; *Suydam* v. *Williamson,* 24 How. 427; *Walker* v. *The State Harbor Commission,* 17 Wall. 648; *Barrett* v. *Holmes,* 102 U. S. 651. And this is the rule even though the state rule is not approved.

Walker v. *The State Harbor Commissioner, supra; Bucher* v. *Cheshire Railway Co.*, 125 U. S. 555; *Balkam* v. *Woodstock Iron Co.*, 154 U. S. 177. To avoid the uncertainty and injustice which results from 'the discordant element of a substantial right and which is protected in one set of courts and denied in the other, with no superior to decide which is right,' (*Ryine* v. *Insurance Company*, 96 U. S. 627), this court has not hesitated, when there has been a conflict of decision between it and the state courts affecting a rule of property within the state, to overrule its own decisions and to follow the state decisions, once it has become evident that they have established a 'rule of property' as the settled law of the state. *Green* v. *Lessee of Neal*, 6 Pet. 291; *Suydam* v. *Williamson, supra; Fairfield* v. *County of Gallatin*, 100 U. S. 47; *Roberts* v. *Lewis*, 153 U. S. 367, 376. And see *Bauserman* v. *Blunt, supra*, overruling a decision of the Circuit Court antedating a conflicting decision of the state court. We are, therefore, constrained in the present case to accept the view of the state courts as announced by them without inquiring, as an original proposition, into the justice and sufficiency of the rule which we follow" (l. c. 463, 464).

Although there was a state statute and its interpretation involved in the case, it was the decisions of the state court that were held by this court to be determinative of the issues in the Federal Court. At page 362 Mr. Justice Stone said:

> "Both the meaning of statutes of a State and the rules of the unwritten law of a State affecting property within the State are peculiarly questions of local law to be ascertained and established by the state courts" (l. c. 462).

The Kuhn case was a tort action, affecting real property. The case at bar is an action involving a right

and interest in and to real property. There is a real difference between the cases. Conflict between state and Federal decisions is not quite as serious in tort actions, for there, principles of general common law are usually determinative and, by the very nature of the cases, forecast cannot be made with any certainty as to what result might be reached. But conflict between state and Federal law in the same state, where rights and interest to real estate are involved, is especially undesirable because predicability is and has been of paramount consideration. That distinction makes the *Edward Hines Trustees* v. *Martin, supra*, case closer to the case at bar for there is a near connection between an action to remove a cloud on title to real estate and an action to cancel a lease, both of which are different than a tort action even though the tort affects realty.

In *Smith Purifier Co.* v. *McGroarty*, 136 U. S. 237, 10 Sup. Ct. 1017, 34 L. Ed. 346, the action was in *equity* and it was held that a certain mortgage, having been held by the Supreme Court of Ohio to be invalid against general creditors, must likewise be held invalid in the Federal Court. Mr. Justice Gray said:

> "The present case is to be decided by the application of the law of Ohio to the facts stated in this bill and admitted by the demurrer; and the best evidence of that law, as affecting the validity of the mortgages and assignment, is to be found in the decisions of the Supreme Court of Ohio."

In that case, it appears that the mortgage and assignment were made in 1885, and the state decision relied upon was rendered in 1889, or four years *after* the

rights of the parties had accrued, but at a time prior to the action in the Federal Court.

In *Harrell* v. *United Carbon Company*, 52 Fed. (2d) 790, (C. C. A. 5, 1931), it was held that a state decision, made subsequent to an oil and gas lease and after the Federal case was argued in the Circuit Court of Appeals, was binding on the Federal Court, and that partial cancellation should be decreed in accord with the state law thus announced.

3. The Kansas decisions establish the rule of law that there is an implied covenant in an oil and gas lease, to continue with reasonable diligence the work of exploration, development and production after the expiration of the primary term, if during that term oil is found in paying quantities.

In *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005 (1918), the lease covered two separate tracts of land, one of 220 acres and the other for 716 acres, for 10 years and as much longer as gas or oil may be found in paying quantities. 25 wells were drilled on one tract and none on the others. The primary term had expired. The court said:

> "Since plaintiff's lands are burdened with an oil and gas lease he is entitled to have those lands prospected for oil and gas within a reasonable time. "'*On principle, it would seem that there is such implied covenant in the written instrument. When no time is fixed for the performance of a contract, a reasonable time is implied * * * So, under an oil lease which is silent as to the number of wells to be drilled, there is an implied covenant that the lessee shall reasonably develop the land and reasonably protect the lines*'" (*Harris* v. *Ohio Oil Co.*, 57 Ohio St. 118, 127).

In *Webb* v. *Croft*, 120 Kan. 654, 224 Pac. 1033, the primary term had expired and the court said:

> "Lessees of this kind contemplate exploration and development and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor the limiting of development to an extent merely to prevent a declaration of forfeiture. *Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both the lessor and lessee*" (l. c. 657).

In *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500 (1926), the action was to cancel an oil and gas lease after the expiration of the primary term of 10 years and after one well had been drilled which produced oil in paying quantities and the court said:

> "A lessee may not hold an entire quarter section of land with a single producing well after expiration of term, any more than he may do so before expiration of term. *The implied covenant fairly to exhaust capability of the land to produce mineral, subsists*" (l. c. 190).

Culbertson v. *Cement Company*, 87 Kan. 529, 125 Pac. 81 (1912), states that:

> "Since the number of wells to be drilled on the land was not specified there was an implied obligation on appellants to fully develop the land and put down as many wells as necessary to secure to appellee his proportionate share of the pool of gas" (l. c. 535).

To the same effect see *Mills* v. *Hartz*, 77 Kan. 218, 94 Pac. 142 (1908), and *Howerton* v. *Gas Company*, 81 Kan. 553, 106 Pac. 47 (1910).

4. The obligation to explore and develop requires the lessee fairly to exhaust the capability of land to produce minerals and if the undeveloped portion will not produce minerals in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of the provisions in the lease extending the term so long as oil and gas are produced in paying quantities.

The above principle has been established by a line of decisions of the Supreme Court of the State of Kansas.

Mills v. *Hartz*, 77 Kan. 218, 94 Pac. 142 (1908), was an action to cancel a lease giving "exclusive right to dig, bore and mine for gas, petroleum oil and coal," for twenty years, and as much longer as said minerals were produced in paying quantities. Lessor was to receive a royalty per ton, gas for domestic purposes, and $50 per annum for gas obtained from each well. Development was not required within any fixed time. The lessee did no developing and, after 7½ years, this action was brought to cancel the lease for his failure to explore and develop. He contended that the lease did not provide for immediate exploration, but that he had twenty years to explore and develop. In sustaining the ruling of the trial court canceling the lease and the contention that the lease was granted upon an implied condition that the lessee should explore and develop within a reasonable time, the court stated the principles governing mineral leases as follows:

> "We think the court rightly held that, under such a lease, it is the duty of the lessee to make diligent search within a reasonable time. The only consideration moving to the lessor for the right which he gave to the lessee to explore and procure minerals

was the royalty on the coal to be found and the fixed compensation for each well when gas should be found and utilized, together with sufficient gas to supply two stoves in his farmhouse. *If there were no search, nor any product, no possible benefit could come to the lessor for the exclusive rights which had been given to the lessee. It is not easy to infer that the lessor intended to give a valuable right for a nominal consideration, and permit the lessee to retain the right for a period of twenty years without development, when development was the chief purpose in the execution of the lease.* Neither the character of the right given nor the nature of the instrument admits of such an irrational interpretation. The lease contemplates that the lessee shall proceed to dig and bore for gas, oil and coal, and that the lessor shall obtain gas for his farmhouse, not twenty years hence, but as soon as it can reasonably be procured" (l. c. 220).

"*No lease of land for rent, for a return to the landlord out of the land which passes, can be construed to be intended to enable the tenant merely to hold the lease for purposes of speculation without doing and performing what the lease contemplated*" (*Bluestone Coal Co. v. Bell*, 38 W. Va. 297, 18 S. E. 493).

"There is, perhaps, no other business in which prompt performance is so essential to the rights of the parties, or delays so likely to prove injurious —no other class of contracts in which time is so much of the essence.

"*Where the only consideration is prospective royalty to come from exploration and development, failure to explore and develop renders the agreement a mere nudum pactum, and works a forfeiture of the lease,* for it is of the very essence of the contract that work should be done * * * *No such lease should be so construed as to enable the lessee who has paid no consideration to hold it merely for speculative purposes,* without doing what he stipulated to do, and

what was clearly in the contemplation of the lessor when he entered into the agreement" (*Huggins* v. *Daley*, 40 C. C. A. 12, 48 L. R. A. 320).

In *Howerton* v. *Gas Company*, 81 Kan. 553, 106 Pac. 47 (1010), an action to cancel an oil and gas lease, dated November 20, 1902, which provided that a well should be drilled in one year with one-tenth royalty of oil delivered to the lessor, and, if gas was found in paying quantities $50.00 per year for each gas well, a gas well was completed within the year and the production had in commercial quantities sufficient to justify the expense of marketing, but failed to market the gas. The lease was for 10 years and as long thereafter as oil or gas was produced in paying quantities. One well was drilled within a year producing paying gas. There was no further development. In holding that this failure was equivalent to a failure to explore at all, the court stated principles and quoted from authorities, as follows:

> "It is difficult to distinguish in principle between a case like that, where a default consists in a failure to explore at all, and a case like the present one where a well has been drilled and gas found but no effort has been made to utilize or market it. The result to the lessor is the same in either case, except that in the latter he has the satisfaction of knowing that his premises are capable of production (560-1)."
>
> "*It is unreasonable to suppose that it was understood that the completion of one well, without operation or production, except to furnish gas for the plaintiff's home, was all that the lessee was bound to do for more than four years*, in which time, it might be fairly presumed, many wells would be drilled in nearby territory and gas marketed therefrom, as in fact actually occurred.

"'Generally all leases of land for the exploration and development of minerals are executed by the lessor in the hope and upon the condition, either express or implied, that the land shall be developed for minerals; and it *would be unjust and unreasonable, and contravene the nature and spirit of the lease, to allow the lessee to continue to hold under it any considerable length of time without making any effort at all to develop it according to the express or implied purpose of the lease;* and, in general, while equity abhors a forfeiture, yet, when such a forfeiture works equity, and is essential to public and private interests in the development of minerals in land, the landowner, as well as the public, will be protected from the laches of the lessee and the forfeiture of the lease allowed, where such forfeiture does not contravene plain and unambiguous stipulations in the lease. This principle will be more readily enforced and applied by the court as to gas-and-oil cases because of the peculiar nature of those minerals and the danger of entire loss to the lessor of oil or gas in his lands by reason of well drilling on adjacent lands'" (11 L. R. A. (N. S.) 417; l. c. 558, 559).

"'In grants of the character in question, the title is inchoate, and for the purpose of exploration only, until oil or gas is found in quantities warranting operation; and while the courts manifest a disposition to protect the grantee at this stage by treating his interest as no longer postponed to the happening of a condition precedent, yet it is *thoroughly settled that he can not omit to develop the property and hold the grant for speculative purposes purely*'" (*Gadbury* v. *Ohio etc. Gas Co.*, 162 Ind. 9, 14).

"'It would be unjust and unreasonable, and contravene the nature and spirit of the lease, to allow the lessee to continue to hold his term a considerable length of time, without making any effort at all to mine for gold or other metals.' Such a construc-

tion of the rights of the parties would enable him to prevent the lessor from getting his tolls under the express covenant to pay the same, and deprive him of all opportunity to work the mine himself or permit others to do so. The law does not tolerate such practical absurdity, nor will it permit the possibility of such injustice'" (*Conrad* v. *Morehead*, 89 N. C. 31, 35).

"* * * The *testing provided for in such case was of the very essence of the contract, not only with respect to the time within which it was to be done, but as to the thoroughness and certainty with which the mineral value of the lands should be ascertained.* * * * The "testing" provided for was manifestly a condition upon which the lease depended. If such test showed no minerals, then the contract was at an end; if it, on the other hand, showed the presence of valuable mines then the lessees were bound to operate them in good faith for the joint profit of themselves and the owners of the fee. * * *" (*Petroleum Company* v. *Coal, Coke, and Manufacturing Company*, 89 Tenn. 381, 388, 389)."

The court canceled this lease, but, in subsequent decision, *Howerton* v. *Gas Company*, 82 Kan. 367, 108 Pac. 813 (1910), reversed the decree of cancellation and provided that the lessor should prove its damages at a trial, but that if it should be ascertained that such rule could not be applied, an alternative decree should be entered requiring the lessee to proceed, within a reasonable time, fixed by the court, to drill wells and protect the land leased and, upon his failing to do so, that the lease be canceled. In this case, the court approved the principles hereinabove quoted from the first opinion.

It will be contended that the original opinion in this case was withdrawn on rehearing. Not so! It was stated

that: "The court is satisfied with the former opinion, except in one particular. It was held that there was an adequate remedy in damages for the default of the defendant."

Syllabus 1, of the opinion in this case, at 82 Kan. 367, expressly states that:

> "Adhering to the decision on a former hearing (*Howerton* v. *Gas Co.*, 81 Kan. 553) that the contract contemplated that other wells should be drilled with reasonable diligence to utilize this lease * * *"

and said authority has been cited with approval in *Day* v. *Kansas City Pipe Line Co.*, 87 Kan. 617, 622, 125 Pac. 43; and in *Alford* v. *Dennis*, 102 Kan. 403, 406, 170 Pac. 1005. It is true that the court required proof of damages, but stated that:

> "This is not a case where royalty payments in a share of the product are provided for but is an agreement to pay $50.00 per annum for each gas well."

Damages therefore were definitely ascertainable, a situation not present in the instant case, which will be pointed out more specifically hereinafter.

In *Culbertson* v. *Cement Company*, 87 Kan. 529, 125 Pac. 81 (1912), although the facts are different, the following principle announced is applicable:

> "Since the number of wells to be drilled on the land was not specified there was an *implied obligation* on appellants *to fully develop the land and put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas*" (l. c. 535).

In this case the court cited with approval from *Kleppner* v. *Lemon*, 176 Pa. St. 502, where an oil and gas lease

providing for one-eighth royalty and $500.00 per annum for each gas well, contained no distinct covenant for putting down wells, except the first one, as follows:

> "But in a lease for oil purposes, a stipulation that other wells shall be put down where the land is shown to be valuable for oil by the production of the first or test well, is not indispensable. * * * *it is an implied condition of every lease of land for the production of oil therefrom that when the existence of oil in paying quantities is made apparent the lessee shall put down so many wells as may be reasonably necessary to secure the oil for the common advantage of both lessor and lessee.* * * * Whatever ordinary knowledge and care would dictate as the proper thing to be done for the interest of both lessor and lessee under any given circumstances is that which the law requires to be done as an implied stipulation of the contract."

In *Day v. Kansas City Pipe Line Company*, 87 Kan. 617, 125 Pac. 43 (1912), a judgment was entered canceling a gas lease for failure to develop properly. The lease required four wells to be drilled within six months and to continue drilling as long as paying wells were found or royalties were paid. Four wells were drilled on one 80 acre tract and nothing further was done for a period of four years. After the suit was filed four additional wells were drilled on another 80 acres, producing oil in paying quantities, leaving 440 acres undeveloped. Although the primary term had not expired, an action was brought to cancel the lease, and the decree canceling the same as to 440 acres, upon which no wells had been drilled, was affirmed. The case is distinguishable in that there was an express covenant "to continue drill-

ing as long as paying wells are found or royalties paid." The following statements are applicable:

> "Appellant says that the lease does not expressly provide how many wells should be sunk on the land; that in the development two dry holes were drilled, and that it had reason to believe that further drilling would be attended with great risk and many dry holes be found, and as each costs a large sum of money it was not required to run that risk. It also says that the number of wells which shall be sunk on land is not to be determined by the landowners, nor yet by the courts, but is to be determined by the operator so long as he acts in good faith" (l. c. 622).
>
> "It was the manifest intention that the tract leased was to be developed for the mutual benefit of both parties, and the only substantial benefit to be derived by appellees was the royalties to be paid from drilled and operated wells. It was not enough that exploration should be made and gas found and allowed to remain in place on the land. It was not enough that four wells should be drilled within six months, or any limited number, on a part of the tract, but it was specifically required that drilling should continue with reasonable diligence so long as paying wells could be found. The appellant was, of course, not required to develop land that had been tested and found to be unprofitable for operation, but *if paying wells could not be found on the land or any part of it there is no reason why appellees' title should be longer clouded with a barren encumbrance nor any reason why appellant should resist a cancellation*" (l. c. 622-3).

In *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005 (1918), the lessor executed a lease in 1902 covering two tracts of land, one of 220 acres two miles distant from one of 716 acres for 10 years and as much longer as gas

or oil was produced in paying quantities. Drilling was to commence in six months and three wells were to be drilled by January, 1924. There were twenty-five producing wells on the larger tract, but no exploration was made of the smaller. The primary term had expired. The Supreme Court stated that the plaintiff asks the court to cancel the contract and to decree a forfeiture of it, for the default of one of its implied covenants. Then, citing its earlier decisions, the court said:

> "Unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease, and as it stands it is of no value to defendants. Unless the defendants had a *bona fide* intention to prospect and develop this tract they had no proper purpose in leasing it, and to cancel the lease will do them no injury. While equity abhors forfeiture it likewise abhors injustice" (l. c. 406).

Thereupon, the court directed that the demurrer be overruled, issues be joined, and the facts determined to allow plaintiff damages if they could be definitely ascertained and in the alternative that defendants be required to proceed in good faith to prospect and develop plaintiff's land within a reasonable time to be fixed by the court, and on failure so to do that the lease be cancelled (407).

In *Webb* v. *Croft*, 120 Kan. 654; 224 Pac. 1033, an action to cancel an oil and gas lease for a term of five years and as long as oil and gas or either of them was produced in paying quantities, the consideration was $580.00 cash, one-eighth of the oil and $200.00 for gas produced from each well. A well was to be completed

in 12 months or $580.00 per year paid as delayed rental. One well was completed the day before the expiration of the lease, delayed rentals were paid and there was nothing due the lessor on the lease when the action was begun (655). The lease covered 580 acres with one producing well thereon and the closest developments to the lease were two wells, each three-quarters of a mile away. The defendants claimed that greater development was not justified as there was no market for the gas in the vicinity except such as would meet the needs of the residents of the City of Moline, that it was necessary for them to hold these tracts as a reserve and that it was impracticable and against public policy to drill more wells and produce gas in any greater quantities than could be used under the franchise of the City of Moline. The trial court found that the lease had not been sufficiently developed and entered a decree requiring certain additional drilling operations and payments of money as delayed rentals, retaining jurisdiction to see that the decree was complied with. In response to the defendants' contention that they had kept the lease alive by drilling one well during the lease period, and had paid the accrued rentals and royalties and that the court was not warranted in requiring further development, the Supreme Court said:

> "*Leases of this kind contemplate exploration and development and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture.* Although not expressly mentioned in the lease, there is an implied covenant or

condition that there shall be reasonable development and such operation as will protect the interests of both the lessor and lessee. (*Howerton* v. *Gas Co.*, 81 Kan. 553, 106 Pac. 47; *id.*, 82 Kan. 367, 108 Pac. 813; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; *Harris* v. *Ohio Oil Co.*, 57 Ohio St. 118.) The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling" (l. c. 657).

"We think the court rightly concluded that the land of defendants has not been sufficiently developed. It would be grossly inequitable to hold a tract of 580 acres with no more development than has already been made. Plaintiff was entitled to some remedy for the failure to develop it, and we think it was competent for the court, instead of decreeing a cancellation of the lease, to give the defendants an opportunity to make reasonable development of the land pursuant to their implied covenants, as has already been determined in *Alford* v. *Dennis, supra*" (l. c. 658).

It is well to note that the court ordered additional development on the facts above stated with no showing whatever as to whether the lease was in a proven field or whether production was had on adjacent land or any facts of that character.

McCarney v. *Freel*, 121 Kan. 189, 246 Pac. 500 (1926), was an action to cancel an oil and gas lease dated June 15, 1912, for ten years and as much longer as oil and gas could be produced in paying quantities.

It embraced a quarter section of land. In October, 1912, a well was drilled which produced and still was producing oil in paying quantities. In November, 1917, a dry hole was drilled. No further effort was made to develop, although there were numbers of producing wells drilled and in operation on surrounding land. In affirming the decree of cancelation, the court said:

> "Plaintiff's evidence warranted the inference that defendants have not reasonably developed her land, and have no present intention to do so: * * * *The testimony in support of the defense was, a man would not be justified in drilling any more wells on plaintiff's land.* The court canceled the lease, except as to a tract having a radius of 200 feet surrounding the producing well.
>
> "The judgment was correct, whether based on plaintiff's or on defendants' theory of the case. *A lessee may not hold an entire quarter section of land with a single producing well after expiration of term, any more than he may do so before expiration of term. The implied covenant fairly to exhaust capability of the land to produce mineral, subsists. If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities*" (l. c. 190).

The foregoing decisions constitute an unbroken line of precedent establishing the law of implied covenant to develop and explore an oil and gas lease in the State of Kansas, support the findings of the trial court and compel a result different from that arrived at by the Circuit Court of Appeals. The court followed the rule that the measure of diligence is what, under the circumstances,

an ordinary prudent operator would do, having regard to the interest of both lessor and lessee, following its prior opinion in *Denker* v. *Mid-Continent Petr. Corp.* (C. C. A. 10, 56 F. (2d) 725), involving the cancelation of an oil and gas lease on land in Oklahoma. This was not the law in Kansas either before or after the execution of the Sauder lease. The Mills, Howerton, Culbertson, and Day cases (*supra*) established the principle contended for by petitioners prior to 1912. Immediately after the lease was made there came *Alford* v. *Dennis*, *Webb* v. *Croft*, and *McCarney* v. *Freel* (*supra*), in rapid succession and all without any intimation by the Kansas Supreme Court that there was even a scintilla of conflict with the earlier cases. They establish that there has been no change in the rule of property involved applicable to the instant case, and the decisions of the Kansas court adhere to the same general test first announced in *Brewster* v. *Lanyon Zinc Co.* (C. C. A. 8), 140 Fed. 801, but the Kansas court places more emphasis on the phrase "having due regard for the interests of the lessor" than does the Federal court.

To state that in the foregoing cases there was no expert testimony that a reasonably prudent operator would ~~not~~ have drilled additional wells on the Sauder lease; or no evidence that had additional wells been drilled oil or gas would ~~not~~ have been discovered in paying quantities; or that the court assumed that oil could be so produced in paying quantities; or that a statement by the court that unless the land were to be developed some time there was no reason to have included it in the lease was *obiter dictum;* or that an opin-

ion is short and doesn't cite any authorities; do not shake the principles enumerated. The rationale is the same whether one well has been drilled as required by the lease or none have been drilled. In determining whether or not there has been an absence of diligence, the Kansas decisions put a real meaning and greater emphasis on the phrase, "having due regard for the interests of the lessor" than other jurisdictions, and it will be shown hereinafter at subdivision B-1 of this brief, pages 58-65, that the absence of diligence has been certain and substantial under the facts and circumstances of this case.

On the other hand, if we do not construe correctly the Kansas decisions, the question was at least an open one. Under those circumstances, the rights of the parties should be governed by the later decisions of the Kansas courts rather than by the still later decisions of the Federal court. As Circuit Judge McDermott stated:

> "Why should the rights of these parties be determined by our decision in the *Denker* case, decided in 1932 in ~~1933~~, instead of the decision of the state Supreme Court in the *McCarney* case decided in 1926?" (R. 96).

The respondent came voluntarily to Kansas, and acquired this lease. It is charged with knowledge that the decisions of the Kansas Supreme Court prior to that time emphasized the fact that the prior consideration moving to a lessor was the development of his property and that it would place an emphasis upon the respondent's obligation to "pay heed to the interest of the lessor." To permit it to have applied a rule, Federal or

otherwise, is to permit it to crawl out from under an obligation which it knew, or should have known that it had, and in consideration of which it acquired the right to develop the land of these petitioners. A Kansas resident or company would not have acquired the rights for which it contends. Why should a non-resident acquire rights in Kansas property superior to those which a Kansas citizen would acquire under similar circumstances?

The majority of the Circuit Court took the position that *Webb* v. *Croft, supra,* was Kansas authority in support of the principle applied by it from *Denker* v. *Mid-Continent Petr. Co., supra.* Although it is true that in the opinon in that case reasonable development was referred to as "drilling such number of wells as an ordinarily prudent operator would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling," yet in applying that test as the measure, the court still adhered to the rule that there must be development, and held that it was grossly inequitable to hold a tract of 580 acres with but one producing well thereon. Applying the principle of what an operator of ordinary prudence would do, with due regard for the interests of the lessor, the Kansas decisions hereinbefore set out will not permit the lessee to hold an undeveloped tract for speculation, without any intention to develop it, gamble on the future at the expense of his lessor, and use geologic science to condemn the lease as a justification for

his failure to develop it diligently as being worthless and yet refuse to back up that scientific information by surrendering the lease and letting someone else try it. Under the principles of the Kansas cases, such conduct does not square with "due regard for the interests of the lessor" and constitutes a breach of the implied obligation to explore and develop.

5. Sound reason dictates the necessity of following the rule of property established by state decisions.

Swift v. *Tyson* expressly excepted from the operation of its doctrine state decisions affecting rights to things having a permanent location in the state, cases involving rights and interest in real property, and questions of local law. The extensions of that case have been many, but to extend it under the authority of the Kuhn case to the case at bar works a confusion and doubt as to just what rights the parties may have, instead of securing uniform rules of law.

In place of safeguarding a non-resident from discrimination in matters of title to real property, the decision of the Circuit Court of Appeals in this case subjects the resident to a discrimination. In *Smith Purifier Company* v. *McGroarty, supra,* the court said:

> "It would be an extraordinary result, if the courts of the United States, in exercising the jurisdiction conferred upon them with a view to secure the rights of citizens residing in different States, should hold such a conveyance to be valid against citizens of other States as the Supreme Court of Ohio holds to be void as against its own citizens" (l. c. 241).

In *United States* v. *Cargill*, 258 Fed. 458, the court remarked:

> "For this court to refuse to follow the decisions of the Supreme Court of Arkansas would result in granting to non-citizens of the state, who can maintain action in the national courts, benefits not possessed by citizens of the state, and relief denied to the latter. This should be avoided, if at all possible" (l. c. 466).

As pointed out by Judge McDermott, dissenting in the case at bar (R. 98, 103-4), the effect of the decision in this case gives to a non-resident lessee greater rights than a resident lessee possesses under an oil and gas lease within the State of Kansas. If the lessors had leased the premises to a resident lessee, there could be no question in this case but that the lease should have been canceled. The decision of the trial court was according to Kansas law. A non-resident should have no just cause of complaint if his rights are measured by the same law as that of residents when he comes voluntarily into the state and acquires an interest in or a claim to real estate.

As it has often been pointed out, there is no reason to believe that concurrent jurisdiction was conferred upon the Federal courts in case of diversity of citizenship to make it possible for non-resident parties to secure the application of a different rule than that available to a resident. It was the conception of Chief Justice Marshall that jurisdiction based on diversity of citizenship was to protect the non-resident suitor from local inequality with residents in the application of law to his particular case. *Bank of U. S.* v. *Deveaux*, 5 Cranch 61,

87. It was not for the purpose of securing to the non-resident a different set of rights or rules than those possessed by the resident, but to safeguard against an unfair and an antagonistic application of the same rules and rights which the resident had.

Mr. Justice Holmes has aptly stated the case for Federal courts following state decisions in questions of title and interest to real estate:

> "The title to real estate in general depends upon the statutes and decisions of the State within which it lies. I think it a thing to be regretted if, while in the great mass of cases the state courts finally determine who is the owner of land, how much he owns and what he conveys by his deed, the courts of the United States, when by accident and exception the same question comes before them, do not follow what for all ordinary purposes is the law." *Kuhn* v. *Fairmont Coal Co.*, 215 U. S. 349, at 370.

In this connection, Judge Caldwell, in *Hartford F. Insurance Company* v. *Chicago, M. & St. P. R. Co.*, 70 Fed. 201, states "As a result of these diverse rules of decision, each party to a suit engages in an unseemly struggle to get into that jurisdiction whose rules of decision are believed to be most favorable to his side of the case."

It has also been pointed out that, if a state should enact a rule of general law into statute, it would be the duty of the Federal court to apply that statute. Because a state law is announced by a decision of court, it should have no less effect than when it is announced by statute. See dissenting opinion of Mr. Justice Holmes, *Black & White Taxicab Co.* v. *Brown & Yellow Taxicab Co.*, 276 U. S. 518, 48 Sup. Ct. 404, 72 L. Ed. 681.

Furthermore the result of the wide extension of the doctrine and its uncertainty has led to serious proposals to abolish Federal jurisdiction based on diversity of citizenship (15 A. B. A. Journal 401), and has led to suggested legislation to require Federal courts to follow state decisions in all law except Federal questions (*Senate Resolution* 4333, 69th Congress, 1st Session, *U. S. Daily,* May 4, 1928, p. 585; 69 *Congressional Record* 8439 *et seq.*).

The result of the decision in this case by the Circuit Court of Appeals causes extreme embarrassment in the field of real property rights, title and interest where predictability is especially important. It is impossible to determine one's rights until it is determined in which court the action is to be brought. In addition, predictability is further reduced because of the difficulty of forecasting with any degree of certainty whether the Federal court will regard the precise question one of local or general law. *Kuhn* v. *Fairmont Coal Company, supra; Smith Purifier Company* v. *McGroarty, supra; Edward Hines Trustees* v. *Martin, supra.*

In thus departing from the accepted and usual course of proceedings the Circuit Court has created a conflict of authority in the Circuit Courts. The 8th Circuit, in *Thurlow* v. *Waite-Phillips Oil Co.* (C. C. A. 8), 22 F. (2d) 781, an action to cancel an oil and gas lease as a cloud on the title, held that the matter related to title to real estate, and the Federal Court was bound by the decisions of the Supreme Court of Kansas, even though in the opinion of the court, they have produced a patent and burdensome injustice.

And in *Harrell* v. *United Carbon Co., supra,* an action to cancel an oil and gas lease on Louisiana land, because no wells had been commenced within a five year period, the Circuit Court held that it was bound by the decision of the Supreme Court of Louisiana, which definitely established a rule of property in Louisiana, even though the decision was rendered after the case was argued in the Circuit Court.

6. That the relief sought is in equity does not take from the Kansas decisions their binding effect.

That the relief sought was in equity does not relieve from the binding effect of property rights established by Kansas law. The cases previously cited in Sec. A-2 of this brief establish that when the local law relates to acquisition, rights to, interest in, or liens upon or affecting property located within the state, even though dependent upon the unwritten law of the state, as announced by state court decisions, those decisions are to be followed in a Federal Court sitting in that state.

Local rules of property have the same effect in a court of equity as in a court of law. Many of the cases cited in the foregoing sections of this brief were suits at equity where local rules of property were recognized as binding.

Edward Hines Trustees v. *Martin,* 268 U. S. 458, was an equitable action to remove a cloud on title; *Smith Purifier Co.* v. *McGroarty,* 136 U. S. 237, arose on a bill in equity; *Abraham* v. *Casey,* 179 U. S. 210, was a case in equity; *East Central Eureka Company* v. *Central Eureka Company,* 204 U. S. 266, 27 Sup. Ct. 258, 51 L.

Ed. 476, was an equitable action to quiet title; *Thurlow* v. *Waite-Phillips Oil Co.*, (C. C. A. 8) 22 F. (2d) 781, arose on an equitable bill praying removal of cloud on title and seeking injunctive relief; *Harrell* v. *United Carbon Co.*, (C. C. A. 5) 52 F. (2d) 971 (1931) was an equitable action for partial cancellation of an oil and gas lease for failure to develop within the primary term.

There are numerous other cases in equity following local rules as to substantive rights in or affecting realty or property. *Brine* v. *Insurance Co.*, 96 U. S. 627.

Lancaster v. *Oil Company*, 241 U. S. 551, was an equitable action holding that whether the interest acquired under an oil and gas lease was the subject of ejectment was to be determined in accord with state decisions.

See also: Hughes Fed. Practice, Vol. 7, Sec. 4129, wherein it is said:

> "A rule of property is as applicable in cases on the equity side as in cases on the law side."
> Williams Federal Procedure, 2nd Ed. Chap. XIV, Sec. 8, page 371.

At equity, as at law, the difficulty arises in distinguishing between matters of general equity jurisprudence and strictly local rules of property. In Sections A-1 and A-2 of this brief, it is shown that the matter under consideration is one of a local nature, and that the state decisions constitute rules of property.

A further distinction in equity cases is to be noted. The Federal equity courts are not bound under the conformity act, Title 28, U. S. C. A., Sec. 724, to apply local

rules in matters of procedure. However, as revealed by authorities cited above, in matters of substantial equitable rights, the existence of which depends on local rules of property, local law is decisive in the Federal equity court. Where there exists a substantive right created by local law, the Federal courts are at liberty to determine the *remedy* and whether the right is one of equity or law in the Federal jurisdiction. If it is a right within the Federal equity jurisdiction, the procedure and remedy cannot be controlled by state statutes or decisions. See *Brine* v. *Insurance Co., supra; Watts* v. *Camors,* 115 U. S. 353.

Guffey v. *Smith,* 237 U. S. 101, illustrates the difference between substantive rights and procedural remedy. In that case an action at equity was brought by the holders of an oil and gas lease to enjoin operations under a second oil and gas lease, and to obtain an accounting of oil and gas produced from operations already had, under the second lease. It was said, by Mr. Justice Vandevanter, l. c. 112:

> "It is settled by the decisions of the Supreme Court of Illinois that an oil and gas lease like that of the complainants passes to the lessee, his heirs and assigns, a present vested right—'a freehold interest'—in the premises, that this interest is taxable as real property, and that the clause giving the lessee an option to surrender the lease at any time is valid, does not create a tenancy at will or give the lessor an option to compel a surrender, and does not make the lease void as wanting in mutuality (cases cited omitted). These decisions constitute rules of property and must be accepted and applied in passing upon the complainants' rights."

While the Supreme Court of Illinois fully sustained the validity of such leases and the right to maintain a suit on such leases in courts of law, it was held by the state court that the presence of a clause in the lease giving the lessee the option to surrender it at any time prevented the lessee from enforcing certain provisions of the lease in equity, because it lacked mutuality. In the Federal court such a degree of mutuality of remedy is not a requisite of equity procedure, and it has been frequently held that Federal equity courts are not controlled by a local rule as to enforceability of contracts lacking mutuality. *Union Bag Corp.* v. *Bischoff*, 255 Fed. 187.

Therefore, it was stated by Mr. Justice Vandevanter for this court:

> "By the legislation of Congress and repeated decisions of this court it has long been settled that the *remedies* afforded and *modes of proceeding* pursued in the Federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting."

Thus in that case this court recognized and held binding the validity of the substantive rights under the lease as announced by the local law, but applied the Federal court's own equitable procedural remedy, which did not exist under the state law.

It is submitted from the above authorities that as to substantive rights, as rules of property not constituting matters of general law, Federal equity courts are bound by state law, although the particular remedy

to be applied is within the determination of the Federal court.

The implied covenant to explore and develop the leased premises is a substantive right in the Kansas law,

McCarney v. *Freel*, 121 K. 189,
Alford v. *Dennis*, 102 K. 403,
Brewster v. *Lanyon Zinc Co.*, 140 F. 801,

and the ordinary remedy in the Federal equity court for breaching that covenant is cancellation.

Brewster v. *Zinc Co.*, *supra*.
Harrell v. *United Carbon Co.*, *supra*.

7. There is certain and substantial evidence that respondent breached its obligations to explore and develop with reasonable diligence.

The discussion in support of this point is set out in subdivision B-1, pp. 58-65 of this brief, and is inserted here by reference to avoid repetition.

8. Plaintiff had no adequate remedy at law.

In opposition to the petition for a writ of certiorari, respondent contended that plaintiff must prove that his damages at law are not susceptible of measurement as a pre-requisite to the right to cancel the lease. This was on authority of *Howerton* v. *Gas Co.*, *supra*. That contention was raised for the first time in this court. In that case the court did hold that the plaintiffs had failed to show, as they were required to do in order to attain equitable relief, that damages would not accord adequate remedy. But in that case no royalties were involved, but only an agreement to pay $50.00 per annum for each gas well. The court said:

> "The measure of damages * * * is the sum the plaintiffs have lost or may lose by the failure of the defendant to complete the number of producing wells necessary to develop the resources of the leased land, and to protect its lines. When the plaintiffs shall have received $50.00 per year for each well from the time it should have been drilled, they will have received the full compensation agreed upon in the lease. Under the terms of the lease they have no share in the product of the wells, no concern as to the disposition which shall be made of that product, and the rules to be applied where the lessor is given a royalty are not entirely applicable here" (l. c. 370).

That is far different from the instant case where the sole consideration of the lessor depends on production and the amount; where drainage will seriously impair his interest; where the intention not to develop is apparently a continuing one; where the amount which might be produced is most important, yet is not susceptible of certain ascertainment; and where cancelation is more consonant with right, justice and morality than to withhold equitable relief.

Damages were mentioned in *Alford* v. *Dennis, supra.* That case went up on demurrer. The court announced the principles with reference to the duty to explore, directed the overruling of the demurrer, and the inquiry into the facts, to allow damages if they could be definitely ascertained and in the alternative to require the lessee to explore upon failure to cancel the lease. In *Webb* v. *Croft, supra,* the court said:

> "There is a suggestion that damages was a proper remedy for plaintiff rather than a decree for development. An action for damages, however, is not ade-

> quate nor at all practicable, since there is no way to ascertain the extent of damages sustained, but it is within the power of a court of equity to require proper development within reasonable times, and if there is a failure of compliance by defendant, plaintiff would be entitled to absolute forfeiture'' (l. c. 658).

The right to equitable relief has been upheld in an action to forfeit and cancel a recorded contract for the sale of land (*Westbrook* v. *Joseph Schmaus,* 51 Kan. 558, 33 Pac. 306), and in the cancelation of oil and gas leases (*Mills* v. *Hartz, supra; Day* v. *Kansas City Pipe Line Co., supra; Webb* v. *Croft, supra;* and *McCarney* v. *Freel, supra; Brewster* v. *Lanyon Zinc Co., supra*). In *Preston* v. *Oil Co.,* 108 Kan. 810, 196 Pac. 1098, an action to cancel an oil and gas lease, defendant contended that plaintiff did not allege or prove that he was without remedy at law. The court said:

> 'An adequate remedy at law which will preclude proceedings in equity must be equally complete, efficient, practical and prompt with the remedy in equity'' (l. c. 812).

And that facts will confer jurisdiction without reference to the pleadings, saying:

> ''The petition in this case alleged that the lease was executed to secure the full development of the land for oil and that the grantee and its successors had failed to comply with the purpose of the lease and the defendants were not making any effort to develop it but withholding it for speculative purposes only * * * It would seem self-evident that under the circumstances thus set forth, mere damages could not well form the only object for which the plaintiff could seek relief from the courts in this state * * *'' (l. c. 813).

Under these authorities and the facts of this case, plaintiff had no adequate remedy at law and was entitled to proceed in equity.

B. The Circuit Court of Appeals Erred in Holding That There Was no Breach of the Implied Covenant to Explore and Develop.

1. Even though the rule contended for by the respondent be adopted, there is certain and substantial evidence that it has breached its implied covenant to explore and develop with reasonable diligence.

The rule adopted by the majority opinion below, with respect to development was that "there is an implied obligation on the part of a lessee to drill such wells as under the circumstances an operator of ordinary prudence, *having regard for the interests of both the lessor and lessee, would drill*" (R. 88-9). It further held the respondent had not breached any covenant, express or implied and that the trial court did not find that it had breached its implied obligation (R. 89); and that the trial court was requiring the company to do what a prudent operator would not do. The court does say that if there were "slight indication that the undeveloped portion contains oil or gas in paying quantities, regard for the interest of the lessee, as well as the lessor, would require further development." But under the facts as they existed, held it was not required.

What are the facts and what do we mean by the phrase "having regard for the interest of the lessor?"

Petitioners have 360 acres of land; they turn it over to respondent, give him right to explore for oil

and gas for 10 years or as long as produced in paying quantities, on a royalty basis; give possession for the purpose, the right to pay off encumbrances on the land and have a lien therefor; and make it binding on the heirs, assigns and successors. The express covenant required it to drill one well within one year. Respondent drills two wells way down in the Southwest corner, offsets to wells in practically a virgin field—they produce oil in paying quantities and have continued to do so for 10 years.

Wells are drilled on land adjacent to and surrounding, year after year, a great proportion of which are producers—to the Northeast, East, Southeast, South, Southwest and West—76 producing wells on adjacent land, and but 6 dry holes and 2 abandoned (Exh. 1-66-A). In addition, there are 84 producing wells on land immediately surrounding, all of which produce from the Mississippi lime (Exh. E-72-A), a formation which underlies the lease in question. The respondent owns the Southwest Quarter of Section 15, lying adjacent on the East, on which it drills 10 wells, gets 10 producers, but has to abandon one; also owns the Northwest Quarter of Sec. 22, lying adjacent on the Southeast, on which it drills 12 wells and gets 12 producers; also the North Half of Sec. 21, lying immediately adjacent in the South, on which it drills 11 wells, gets 10 producers, one of which has to be abandoned.

In the meantime it takes $72,694.18 off the lease as its share, which pays back its entire investment, all operating expenses, etc., and $26,229.21, additional profit in 10 years' time. In the meantime respondent does

nothing to further develop the 360 acres and leaves lessee sitting. When asked to develop, its officers say it has no intention to do so unless some one else takes the gamble and proves that it should. In the meantime, for 17 years, lessor sits quietly by with a cloud on his title, the existence of oil an established fact, in a recognized oil field, and watches production develop all around him and faces that continuous condition—the only tract in a trend—Northeast and Southeast—for five miles, without development.

The Circuit Court says an ordinarily prudent man wouldn't drill, that a reasonably diligent man having regard for the interest of the lessor and himself would continue to sit by.

There isn't any question as to what ordinary horse-sense of a layman would dictate. But respondent says the geologic inference is unfavorable—and that the indications are that there is no Bartlesville sand under the lease, and a lime foundation under the Sauder lease is from 570-610 feet below sea level, and wells encountered at greater depth than 570 feet in this vicinity are dry holes. Sure there are dry holes between 590-610 feet, but there are also dry holes as high as 564 feet. But between 570-610 feet there are 23 producing wells on the East half of Section 20, West half of Sec. 21, in adjoining sections—9 of which are higher than 570 feet; and 20 producers in the same range in Sec. 29 adjoining it on the Northeast and 17 in a field adjoining on the Northeast.

Respondent's officers testify that three dry holes around the Sauder lease, one on the North and two on

the West of the land indicate the absence of oil. Although they were practical men they gave opinions as to their theories only—admitting they might be wrong, would not say they could tell where oil could be found, and stated the only way to determine with certainty was by drilling wells. One of them testified that he did not think there was any drainage.

Although Theta No. 2 is dry to the north, there is production to it close on the East, Northeast, North, and Northwest. Although Theta No. 21, is dry (SW ¼, Sec. 10), there are four producers in a line straight South and around it. Although Gillespie No. 4 (Northeast ¼, Sec. 20) is dry, there are wells North, Northwest and Northeast around it; although Florence No. 2 (SW ¼, Sec. 16) is dry, there is production South, Southeast, Southwest and West, and Northwest; although Syndicate No. 1 (NW ¼, Sec. 16) is dry, there is no development close enough to it to make it of any significance. Suppose Florence No. 1 had been drilled first. On respondent's theory there would never have been any production in the Southwest Quarter of the Sauder lease, and in the territory around it. The truth is that the Sauder land is neither proved nor condemned. No one will ever know whether the interests of the lessor and lessee are being protected until wells are sunk and the anxiety of respondent to keep the well corroborates that fact.

The respondent never has developed or explored at all. The lease contemplated the drilling of one well within a year for the purpose of finding out whether there were oil or gas. The lessee was willing to spend

his money for that purpose—just to find out. It has never done that. Production was brought in across the Sauder line and respondent drilled two offset wells on a sure thing and to perform its implied covenant to protect the lines. It has never yet performed its implied covenant to explore within the contemplation of the parties.

The following shows the respondent's return from the two wells:

Respondent's share from 2 wells to 12-31-31		$72,694.18
Total cost of drilling, equipping and operating	$46,464.97	
Cost of drilling and equipping 2 wells	32,000.00	
Cost of operation		14,464.97
Gross profit from operation Nov. 7, 1921) to Jan. 12, 1922) 12-31-31.		58,229.21
Gross profit from operation per year		5,822.92

Amount invested—$32,000.00. Rate return per yr. 18.2%

Depreciate the investment over 10 years and it will have earned them approximately 23% of the investment over that period—pay them back all the investment and leave them with clear income of whatever it pays from now on—depending on production and price of oil —now about $1,500.00 a year.

Out of this maze of testimony—opinion evidence conflicting with the physical facts, the court found:

With reference to drainage—That there was no absolute way of determining the question of drainage except by drilling tests, and that there is some probability that drainage is being done to this leasehold by draining on adjoining properties.

With reference to the possibility of oil—The court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of Section Sixteen (16) but no dry well has been drilled on any of the property covered by said lease (R. 35).

On the question of intention to explore—No effort has been made by the defendant since said letters toward exploration or development by the drilling of wells or otherwise and the evidence in this case shows that the defendant and its officers and employees have no present intention of further exploring or developing said lease and no intention ever to further develop said lease unless and until further developments in the immediate vicinity thereof might convince said defendant and its officers and agents that it would pay the defendant to further explore or develop said lease. Evidence of the defendant tends to show that the land covered by the lease in the instant case is worthless for oil drilling purposes (R. 36).

The Circuit Court says that the trial court did not find that the implied covenant had been breached and that there would be no evidence to support such a finding. The trial court found that there was a probability of damage from drainage, which could be determined only by drilling tests; that there was no positive evidence of oil under the land and nothing but exploration and test by drilling could determine whether it was there in paying quantities; that defendant had not drilled for that purpose nor had any dry well been drilled on the premises; that defendant had no intention of making further exploration or development on its own initiative; that the land was worthless for drilling purposes; and concluded that if it was worthless it was not equitable and just to permit respondent to hold this large tract of land as a cloud on petitioners' title. And calling attention to the fact that the defendant's diligence in exploring the premises was of paramount importance, concluded that respondent had not shown that diligence as required in law, equity and good conscience; that plaintiffs had no remedy at law; that the defendant had not in good faith and with reasonable diligence explored and developed the land in accordance with the express and implied covenants of the lease; and that it would be inequitable to permit them to hold and retain it without further exploration or development as it proposes to do. Adding to the facts found by the court, the admission by respondent that its geological records showed that the Northwest corner of the lease had not been developed as thoroughly as the edges and that it was not

impossible of further development in that Northwest corner, certainly there is ample evidence to support all of these findings of the court and the conclusions drawn therefrom are the natural inferences which fairness and equity would dictate.

2. Brewster vs. Lanyon Zinc Co.

Respondent relies so strongly on *Brewster* v. *Lanyon Zinc Co., supra,* that we shall submit an analysis of this Brewster case and the Sauder case, confident that the principles of the Brewster case support petitioners' contentions. It is the leading case in American jurisprudence on the subject of "Implied Covenants Diligently to Explore," decided in 1905, Justice Vandevanter, writing the opinion. It is a Kansas case, seeking to forfeit an oil and gas lease on land in Allen County, Kansas, and to cancel it as a cloud on plaintiff's title. The court was considering an implied covenant to continue exploration and development after the expiration of the fixed period of development, during which oil had been discovered in paying quantities, and whether a breach of said covenant had been committed. As it is cited as authority in both the majority and dissenting opinions in the instant case, an analysis should prove interesting.

BREWSTER VS. LANYON ZINC CO., (C. C. A. 8) 140 Fed. 801:

	Brewster Case	*Sauder Case*
	(a) THE LEASE	
1. Subject:	Oil & gas and right to search and produce	The same
2. Nature of action:	Suit in equity to establish forfeiture and cancel	Suit in equity to cancel
3. Dates of lease:	October 28, 1895	June 6, 1915
4. Primary term:	5 years	10 years—or as long as oil or gas can be procured in paying quantities;
5. Acreage:	312½ acres—3 separate and distinct tracts, only 2 finally involved, 8 miles apart	360 acres in one block
6. Rights of lessee:	To oil and gas under premises with right to enter for purpose of drilling; To erect structures, pipe lines, etc., and remove same; To excavate for and use water,	To enter upon, operate for, and procure oil and gas; To erect pipes, structures, machinery and remove same; To use water and drill for or make ponds necessary for op-

	gas, and oil necessary to operate	eration; To discharge encumbrance and have a lien therefor;
7. Express covenant as to drilling:	One well to be drilled within 2 years, or Pay $78.00 annually until drilled; If no well is drilled within 5 years, lease null and void; Rental to be deposited in bank to credit of lessor; Failure to comply with covenants renders lease void;	Commence well within 1 year—in default, lease to be canceled on notice, or Pay annual rental $1.00 acre from year to year until a well is drilled; Rental to be deposited in bank to credit of lessor;
8. Lessor receives:	1-10th of oil; Gas for domestic use; $50. per each well from which gas is used off premises	1-8th of oil; Gas for domestic purposes; $100. per year for gas, if sold;
9. Duration:	Lessee's rights available to successor or assigns;	Contract binding on heirs, assigns, successors and personal representatives of the parties;
10. After primary term:	No express covenant for development after primary term;	No express covenant to explore after primary term;

(b) FACTS *re* EXPLORATION—
PAST AND FUTURE.

11. Exploration, etc.:	Well drilled in 5th year producing gas in paying quantities—has since been produced and used; No further development up to time of suit (14 months after expiration of primary term); $50.00 annual payment for gas may have been paid;	Two wells drilled (1921-1922) which then and ever since have produced oil in paying quantities; No further development up to time of suit—approximately 14 years; No gas;
12. Surrounding territory:	Many oil and gas wells drilled in adjacent and surrounding territory which furnish oil and gas in paying quantities;	76 producing wells on land adjacent; 84 on other close surrounding land—and from Mississippi Lime which underlies Sauder lease, practically all drilled after Sauder wells—66 of them from same lime formation depth as under Sauder lease. Lessee owns land adjacent on East, Southeast, and South on which it has 30 producing wells;

13. Drainage:	Drainage doing damage—extent not susceptible of ascertainment.	None of wells on adjacent land are "offsets." Geologist thinks no drainage. Court found evidence not convincing, could not be determined except by drilling, but some probability that damage being done.
14. Oil prospects:	No other facts than above;	Geologists and practical oil men say there is none, but admit it is opinion and not certain and could tell more certainly by drilling; Court finds no positive evidence by either party and nothing but exploration by drilling will determine; Northwest corner not impossible of development;

15. Lessee's contention:	By drilling single well, acquired right to oil and gas, and to hold indefinitely without further development, or doing more than paying $50.00 per year for gas;	By drilling single well, performed covenant, secured oil in paying quantities and entitled to hold; no breach because reasonably prudent man wouldn't drill;
	No facts with reference to whether a reasonably prudent man would or would not drill;	
	Purposes to hold for speculative purposes	No immediate intention to develop further; will, if some one else proves the field in the vicinity—claims worthless for oil drilling purpose;
16. Notice by lessor to cancel:	Lessor gave notice in writing 7 days before filing suit.	Lessor made demand to drill on lease about four years before suit was filed and lessee refused because had a valuable lease;

(c) Principles Established by Brewster Case.

1. Only method of determining whether or not particular lands contained oil or gas in paying quantities was by drilling to considerable depth (806);
2. Implied obligation to explore, develop and produce with reasonable diligence for common benefit of both parties (810) if during primary period oil and gas are produced in paying quantities (811);
3. Promise of royalties to lessor is controlling consideration (810);
4. Obvious difficulty in establishing amount of oil and gas in premises, or amount diverted therefrom, a serious obstacle to recovery of adequate damages at law (812);
5. Compliance with covenant to continue with reasonable diligence the work of exploration, development and production, after primary term, if during that time, oil and gas is found in paying quantities, is made a condition, the breach of which entitles lessor to avoid lease (812-3);
6. What constitutes breach is question of fact under particular circumstances (813);
7. Neither lessor nor lessee is arbiter of extent to which, or the diligence with which operation shall proceed, but both are bound by standard of what is reasonable (814);
8. No breach unless absence of diligence is both certain and substantial in view of actual circumstances at the time, as distinguished from expectation of lessor and conjecture of mining enthusiasts. It is only to end that oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required;
9. Whether diligence is exercised depends on (1) Quantity of oil and gas capable of being produced from the premises as indicated by prior exploration and

development; (2) The local market demand and means of transportation; (3) Extent and result of operations on adjacent land; (4) Character of natural reservoir—as to drainage; (5) Usages of business (814);

10. Whatever under the circumstances would be reasonably expected of operator of ordinary prudence, having regard to the interest of both lessor and lessee is what is required (814). A plain and substantial disregard of this requirement constitutes a breach of the covenant for the exercise of reasonable diligence.

(d) Application of Principles to Facts—Brewster Case.

The circumstances under which the right to avoid lease have arisen are:

1. 2 Tracts—8 miles apart—213.5 acres;
2. Both tracts within recognized oil and gas field;
3. Lessee drilled one well and found gas in paying quantities;
4. No additional wells drilled or attempted;
5. Many wells drilled in adjacent or surrounding territory which produce oil or gas in paying quantities;
6. Wells adjacent are so near as to drain;
7. Extent of drainage not susceptible of definition;
8. Lessor cannot be compensated adequately in damages (815);

These circumstances compel the conclusions that:

(a) Show not only an absence of reasonable diligence on part of lessee but a practical repudiation of controlling purpose of lease and a persistent disregard of rights of lessor (815);

(b) Existence of gas in paying quantities is an ascertained fact (815);

(c) Both oil and gas are produced in paying quantities in surrounding land;

(d) Necessary inference is that further exploration and development would have been profitable to lessee as well as benefit to lessor (815);

(e) Prolonged failure of lessee to proceed with contemplated operations was plain and substantial breach of covenant and condition in respect of exercise of reasonable diligence and entitled lessor to terminate (815-6);

(f) Amount of oil and gas not susceptible of ascertainment (816);

(g) Attitude of lessee such that breach promises to be continuing one—and by reason of migratory character of oil and gas, to be injurious to and destructive of lessor's rights (816);

(h) Remedy at law not adequate (816);

(i) Lease is cloud on lessor's title, is destructive of valuable property, is productive of irreparable injury and calls for measure of relief not attainable at law (817);

(j) No objection to forfeiture when that is more consonant with principles of right, justice and morality than to withhold equitable relief (819);

(k) Decisions by Supreme Court of Kansas are in harmony with this view of right to forfeiture (819);

From the foregoing analysis it appears that the terms of the leases are almost identical in substance. If anything, the Sauder case presents a stronger situation on behalf of the lessor in that there is a larger acreage involved, 14 years of activity as compared with 14 months, more definite information as to producing wells on adjacent land, definite production in the lime at the same

depth as the respondent testifies is beneath the Sauder lease, a definite intention not to further develop. The Sauder case presents every circumstance under which the court held the lessor in the Brewster case had the right to avoid the lease except the latter case has the more definite facts as to drainage. Reference to the facts in the statement of the case and the findings of the court show that in the instant case we have 360 acres, within a recognized oil field, ~~one~~ two wells drilled on the premises in question which produced oil in paying quantities, no additional wells drilled or attempted for approximately 14 years, many producing wells in adjacent or surrounding territory, no definite testimony as to the drainage, and the finding of the court that there is a probability of damage from drainage, ascertainable only by drilling, which circumstances compel the same conclusion as stated in the Brewster case: That the existence of oil in paying quantities is an ascertained fact, oil is produced in paying quantities in adjacent and surrounding territory, a necessary inference that further exploration and development would have been profitable to both lessee and lessor, that the failure to explore shows not only an absence of reasonable diligence, but a practical repudiation of the controlling purpose of the lease and a persistent disregard of lessor's rights, that the prolonged failure to proceed is a plain and substantial breach of the implied covenants to exercise reasonable diligence, that the amount of oil is not susceptible of ascertainment, that the attitude of the lessee indicates a continuing breach during which the

lease would be a cloud on lessor's title and be destructive of valuable rights, and that the lessor is entitled to have his lease canceled.

It is significant, that the Brewster case involves a Kansas oil and gas lease, and that that case held that the decisions of the Supreme Court of Kansas are in harmony with the views expressed by it with reference to the right of forfeiture.

We do not think that respondent, experienced in the migratory character of oil and the uncertainty and fallibility of geologic inferences, should be permitted to take the position stated by Circuit Judge McDermott that:

> "Their science is valuable to condemn the lease in court in justification of a failure diligently to develop; but he will not back their testimony by relinquishing the lease" (R. 98).

Respondent's Vice-President frankly stated that he wants to hold it because there may be oil under it. That must be true, otherwise he would not go to the expense and inconvenience of defending this lawsuit. To that extent he does not accord verity to his own geologists. In holding the land for speculative purposes and taking a gamble at the expense of the lessor, there is no due regard for the interest of the lessor. That was a part of respondent's contract, and under any rule of law and fair dealing, the facts of this case should not permit the lessee to hold this property any longer.

VI.

CONCLUSION.

The matter involved, affecting title to real estate in connection with which there is an implied covenant that lessee will fairly exhaust the capability of the lease to produce oil by diligent exploration under the Kansas decisions, which should be followed by the Federal court, which covenant has been breached, the lease should be canceled; or on the respondent's theory for the reasons hereinabove stated there has been not only an absence of reasonable diligence, but a practical repudiation of the controlling purpose of the lease and a persistent disregard of the lessor's rights, under a set of facts where a reasonably prudent operator, having due regard for the interest of the lessor and the lessee, long ago would have done further exploration and development. Therefore, on either theory of the case, petitioners are entitled to a cancellation of the lease as decreed by the trial court.

Respectfully submitted.

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No. 4[illegible]

In the Supreme Court of the United States

October Term, 1952.

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL., Petitioners,

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, Respondent.

Response to Petition for Writ of Certiorari.

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1933.

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, *ET AL.*, *Petitioners,*

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

RESPONSE TO PETITION FOR WRIT OF *CERTIORARI:*

May It Please the Court:

This action was commenced in the District Court of Greenwood County, Kansas, by Phillip Sauder against the respondent, seeking the cancellation of the undeveloped portion of an oil and gas mining lease covering 360 acres of land in said Greenwood County. Subsequent to the removal of said case to the Federal Court Phillip Sauder died and the action was revived in the name of the petitioners herein, who are his sole and only heirs at law. The aforesaid lease was executed and delivered to respondent's predecessors in title on June 6, 1916, and contains the following provisions:

"That the said parties of the first part in consideration of the sum of $1.00 (One) Dollars, receipt of

which is hereby acknowledged to them duly paid by the said parties of the second part, and of the covenants and agreements hereinafter contained on the part of the said parties of the second part, to be kept and performed, do hereby lease and let unto the said parties of the second part the exclusive right for Ten Years from date hereof, *and as long thereafter as oil or gas can be procured thereon in paying quantities*, to enter upon, operate for and procure oil and gas upon the following described premises, situated in Greenwood County, State of Kansas, to-wit, East ½ of Sec. 16, Town. 23, Range 13, Acres 320. Southeast ¼ of Southwest ¼, Sec. 16, Town. 23, Range 13, Acres 40.

* * * * * * * *

"If oil or gas be found *on these premises* by said second parties, *all rights, benefits and obligations secured hereby* shall continue so long as either can be procured in paying quantities.

* * * * * * * *

"In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. *Provided, however*, that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance." (R. 6-7)

The petitioners concede that during the primary term of the aforesaid lease, or in other words, during the first ten years after its execution, the respondent or its predecessors in title completed two wells upon the southwest 40 acres of said lease, that oil was discovered in paying quan-

tities in each of said wells, and that at all times since the completion of said wells they have produced oil in paying quantities and are still so producing. The first of said wells was completed on or about the 1st day of November, 1921, and the second on or about the 1st day of January, 1922. Other than the aforesaid wells there has been no development upon the leased premises (R. 17, 30).

Primary Question Involved Herein.

The primary question herein is whether, under the evidence and the lease sought to be cancelled, there was any implied obligation upon the part of respondent to drill an additional well or wells upon the leased premises.

Petitioners' Evidence.

The only evidence introduced by the petitioners is the map appearing at page 67 of the record, which map was prepared by the respondent, and which shows the location of the wells upon the land involved herein and upon the premises adjacent thereto, the date of the completion of each of said wells, the depth to which each of said wells was drilled and the initial production, if any, from each of said wells.

The petitioners introduced no evidence whatsoever that any of said wells on the adjoining properties produced oil or gas in paying quantities, that is, in sufficient quantities to repay the cost of drilling, equipping and operating said wells, together with a reasonable profit on the entire outlay, or that if respondent had drilled any additional well or wells upon the land involved herein it would probably have discovered oil or gas in paying quantities or that a

reasonably prudent oil operator would have drilled any additional well or wells upon the lands involved, or that any of the wells on adjoining properties had drained, was draining or was likely to drain any oil or gas from under the lands involved herein.

Respondent's Evidence.

George O. Moody, vice-president in charge of production of oil and gas for respondent, and who had been engaged in the oil and gas business for about 32 years, 16 years of which was in Kansas and Oklahoma, Lloyd Snyder, who had charge of the operation of the lease involved, and who had been production superintendent for the respondent in this particular locality for 13 years, L. J. Young, a graduate of geology at the University of Michigan, who had been employed as a geologist by the respondent for 10 years, and S. V. Brown, superintendent of the Shaffer-Howell Drilling Company, which owned the lease covering the Northwest Quarter (NW4) of Section 15, adjoining the lease involved on the east, and who had been superintendent of said company for 10 years, and had drilled all of the wells on the Northwest Quarter (NW4) of Section 15, with the exception of two, testified on behalf of the respondent, giving in detail their reasons therefor, that none of the wells on the premises adjoining the lease involved herein had drained, was draining or was likely to drain oil or gas from under the premises covered by said lease, that development on the premises involved herein and on the adjoining premises clearly indicated that if any additional well or wells had been drilled on the lease sought to be cancelled the same would probably not have produced oil or gas in paying quan-

tities, or in other words, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, and that a reasonably prudent operator would not have drilled any additional well or wells upon said lease (R. 48-65).

Mr. Moody also testified that the total revenue from oil produced from the lease involved from the time the two wells thereon were drilled to December 31, 1931, was $72,694.18; that the royalty paid to the lessors in said lease was between $9,000.00 and $10,000.00, that the total expenditures in connection with the development and operation of said lease was $46,464.97, and that said lease had shown a profit to the respondent of only approximately 5.1% per annum, which was a very small return for an oil venture, considering the large expenditures required and the great hazards involved (R. 48).

It was stipulated by the parties that the total of the 1/8th royalty paid by respondent under the lease involved herein from 1927 to the date of trial was $760.50 for the year 1927, $658.45 for the year 1928, $623.90 for the year 1929, $495.45 for the year 1930, $239.23 for the year 1931, and for the year 1932, up to the date of trial an average of $21.00 or $22.00 per month (R. 46).

Mr. Moody further testified that respondent had never abandoned or intended to abandon any portion of its lease, and that if the future should prove it practical to drill another well on said lease respondent was ready, willing and able to drill it (R. 51).

Respondent's Contention.

Respondent contends that its lease does not impose upon it any implied obligation to drill an additional well or wells upon the leased premises, in the absence of an affirmative showing that, under all the existing circumstances, there was a reasonable probability that oil or gas, in paying quantities, would have been discovered therein, or that a reasonably prudent operator would have drilled such additional well or wells.

The leading case of *Brewster* v. *Lanyon Zinc Co.*, (8 C. C. A.) 140 Fed. 801, which is a Kansas case, involving a lease on lands situated in Allen County, Kansas, sets forth clearly the tests for determining whether a breach of an implied covenant to drill oil or gas wells has been committed. In that case, as in the case at bar, the court was considering an implied covenant to continue exploration and development after the expiration of the fixed period of development, during which oil or gas had been found to exist in paying quantities. In said case Mr. Justice VAN DEVANTER, delivering the opinion of the court, said:

> "Considering the migratory nature of oil and gas, and the danger of their being drawn off through wells on other lands if the field should become fully developed, all of which must have been in the minds of the parties, it is manifest that the terms of the lease contemplated action and diligence on the part of the lessee. There could not well have been an express stipulation as to the number of wells to be drilled, as to when the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the

extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was, therefore, rationally left to the implication, necessarily arising in the absence of express stipulation, that the further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit. * * *"

"But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them. It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the

natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required. A plain and substantial disregard of this requirement constitutes a breach of the covenants for the exercise of reasonable diligence, which, as before shown, is also made a condition of the lease under consideration."

The *Brewster* case was decided in 1905, approximately eleven years before the execution of the lease involved in the case at bar. Since that time it has been repeatedly cited and followed in Kansas and elsewhere. Probably no other decision involving oil and gas law has been cited so frequently. Even Judge McDermott in his dissenting opinion herein is forced to admit that it "is undoubtedly the leading case on the subject of implied covenants diligently to explore and develop." Strangely enough, considering his conclusions herein, Judge McDermott also said: "As I read the decisions of the Kansas Court, they adhere to the same general test as announced in *Brewster* v. *Lanyon Zinc Co., supra*, and followed by our court in *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) 725."

At least three of the Kansas cases upon which the petitioners rely, to-wit: *Howerton* v. *Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; and *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033, cite and follow the *Brewster* case.

In *Webb* v. *Croft*, *supra*, the court said:

"Defendants contend that as they had kept the lease alive by drilling one well during the lease period

and had paid the accrued rentals and royalties, the court was not warranted in requiring further development, and that it therefore had read into the contract conditions not stipulated by the parties and had placed burdens on the defendants not contemplated by the contract. Leases of this kind contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both lessor and the lessee. *Howerton* v. *Gas Co.*, 106 P. 47, 81 Kan. 553, 34 L. R. A. (n.s.) 34; *Id.*, 108 P. 813, 82 Kan. 367, 34 L. R. A. (n.s.) 46; *Alford* v. *Dennis*, 170 Pac. 1005, 102 Kan. 403; *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, 57 Oh. St. 118. The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was a sufficient production to warrant the continuance of exploration and drilling.*"

The *Brewster* case announces the universal rule on the question under consideration, and the following are a few of the illustrative cases: *Goodwin* v. *Std. Oil Co.*, (8. C. C. A.) 290 Fed. 92; *Humphreys Oil Co.* v. *Tatum*, (5 C. C. A.) 26 F. (2d) 882; *Orr* v. *Comar Oil Co.*, (10 C. C. A.) 46 F. (2d) 59; *Cosden Oil Co.* v. *Scarborough*, (5 C. C. A.) 55 F. (2d) 634; *Denker* v. *Mid-Continent Petroleum Corporation*, (10 C. C. A.) 56 F. (2d) 725; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069; *Franklin, et*

al., v. *Wigton*, 132 Okl. 236, 270 Pac. 1; *Robinson, et al.*, v. *Miracle, et al.*, 146 Okl. 31, 293 Pac. 211; *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okl. 158, 189 Pac. 540, and *Empire Gas & Fuel Co.* v. *Haggard*, 152 Okl. 35, 3 P. (2d) 675.

Petitioners' Contention.

In its final analysis petitioners' contention is that the lease involved herein imposed upon respondent an implied obligation to drill an additional well or wells upon the leased premises, notwithstanding the uncontradicted evidence herein that there was no reasonable probability that oil or gas in paying quantities would have been discovered therein, and notwithstanding the uncontradicted evidence that no reasonably prudent operator would have drilled such additional well or wells. In short, their contention is not that respondent was required to reasonably develop but was required to unreasonably develop the premises herein.

None of the Kansas cases, whether decided prior or subsequent to the execution of the lease involved herein, except certain *obiter dictum* in *McCarney v. Freel*, 121 Kan. 189, 246 Pac. 500, conflicts with respondent's contention, but, if anything, they support the same.

In support of their contention that the Kansas cases are contrary to respondent's contention and the holding of the Circuit Court of Appeals herein the petitioners cite: *Mills* v. *Hartz*, 77 Kan. 218, 94 Pac. 142; *Howarton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 108 Pac. 813; *Culbertson* v. *Cement Co.*, 87 Kan. 529, 125 Pac. 81, and *Day* v. *Kansas City Pipe Line Co.*, 87 Kan. 617, 125 Pac. 43, all decided prior to the execution and delivery of the lease involved

herein; and *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005; *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033; and *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500, decided subsequent to the execution and delivery of said lease. None of said cases, however, with the exception of certain *dictum* in *McCarney* v. *Freel, supra*, which was decided subsequent to the execution and delivery of the lease involved herein, supports petitioners' contention, but on the contrary all of said cases, with the exception of the aforesaid *dictum*, support the contention of the respondent and the holding of the Circuit Court of Appeals herein.

The Circuit Court of Appeals considered and reviewed the Kansas decisions, and after announcing the general rule with reference to the implied obligation of an oil and gas lessee to further develop, said:

> "This is the rule announced by the great weight of authority. *It has been approved by the Kansas decisions.* See *Webb* v. *Croft*, 120 Kan. 554, 244 Pac. 1033; *Howerton* v. *Kan. Nat. Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Id.*, 82 Kan. 367, 108 Pac. 813; *Day* v. *Kansas City Pipe Line Co.*, 82 Kan. 861, 109 Pac. 186."

Mills v. *Hartz, supra*, was an action to cancel an oil and gas lease for a primary term of 20 years and as much longer as gas, coal and oil were found in paying quantities. Said lease contained no provision with reference to the commencement of a well on the leased premises. There was no development whatever upon said premises, and after a lapse of 7½ years the action was commenced to cancel said lease. There was no showing that it probably would not have been profitable to drill a well on said premises. The court simply held in said case that where an oil and gas lease con-

tains no provision with reference to the commencement of development there was an implied obligation to commence development within a reasonable time after the execution of the lease and that the failure to commence development was a practical abandonment of the lease. There was no question in said case of the extent of the development required after oil or gas was discovered in paying quantities or of the right of the lessee to hold all of the leased premises after the discovery of oil and gas thereon where the circumstances indicated that oil or gas in paying quantities could not be produced from additional wells. It, therefore, follows that said case is not an authority one way or the other in the case at bar.

In *Howerton* v. *Kansas Natural Gas Company, supra,* the lease involved was executed on the 20th day of November, 1902, and was for a period of 10 years and as long thereafter as oil or gas was produced in paying quantities. Within one year after the execution of said lease a gas well was drilled on the leased premises capable of producing gas in commercial quantities sufficient to justify the expense of marketing the same. Nevertheless no sale of gas was made from said well and gas was not used therefrom in any way except that the lessee used some for fuel to furnish power for the drilling of two wells on adjacent premises leased from other owners. There was no further development or operation on said premises, and on the 17th day of November, 1907, the lessor declared a forfeiture of the lease. Said lease provided that a well should be drilled thereon within one year and contained no provision for the payment of rentals for delay or failure to prosecute the work of development. There was no showing that gas could not be pro-

duced in paying quantities from additional wells, but the inference reasonably to be drawn from the opinion is that if additional wells had been drilled gas could have been produced therefrom in paying quantities. The lessee offered no excuse or justification whateyer for its failure to market the gas from the well drilled or for its failure to further develop the premises. The court in said case simply held that since the lessee was obligated to drill a well, it was further obligated to market the product of said well for the mutual benefit of the parties and that its failure to do so justified a forfeiture of the lease. While the opinion of the court states that the lessee was obligated to reasonably develop the premises, the court did not attempt to define "reasonable development," but it is clear that the court was of the impression that if additional wells had been drilled they would have produced in paying quantities. In the case at bar, as heretofore pointed out, the respondent was producing oil from the premises involved in paying quantities, and the uncontradicted evidence disclosed that oil could not have been found in paying quantities in any additional well or wells. Therefore, the aforesaid case is not an authority for the contention of petitioners.

The opinion in the *Howerton* case, *supra*, was withdrawn on rehearing and the case reversed and remanded for further proceedings, as appears from the opinion in 81 Kan. 553, 108 Pac. 813, and we earnestly insist that the opinion on rehearing in said case is an authority for the contention of the respondent. On said rehearing, the court held that the evidence did not disclose a right to have defendant's lease cancelled, but that the plaintiff was en-

titled to damages for the defendant's default. The court said:

> "The default consisted in the failure to properly develop the leased territory by drilling and operating a reasonable number of wells necessary for that purpose, and the failure to market gas and make the payments, stipulated for the well completed. *No reason is shown why witnesses of experience, acquainted with the gas field, may not testify with reasonable accuracy as to the number of wells which should have been drilled on the leased land both for protection from drainage by neighboring leaseholds and to obtain the gas underneath the land.* No insurmountable obstacle to such proof is perceived by the court, and, in the absence of evidence that it cannot be produced, it is concluded that the plaintiff is not entitled to a remedy by forfeiture or cancellation of the lease. * * *
>
> "It should be observed that this is not a case where royalties payable in a share of the product are provided for, but is an agreement to pay $50 per annum for each gas well. *The measure of damages therefore is the sum the plaintiff has lost or may lose by the failure of the defendant to complete the number of producing wells reasonably necessary to develop the resources of the leased land and to protect its lines.* * * *"

Culbertson v. Iola Portland Cement Co., supra, was an action for an accounting from the defendant for gas obtained and used by it from the plaintiff's land through wells on his land and through wells drilled by defendant on adjoining lands. It was alleged that there was a general pool of gas under plaintiff's land and that the defendant had drilled wells on adjoining premises and through them extracted gas from plaintiff's land. The evidence disclosed, and the referee to whom the case was referred found, that a large quantity of gas had been taken from said land, and the

court held that plaintiff was entitled to an accounting therefor, whether it was obtained from wells drilled on his land or from those drilled on adjacent premises. In its opinion the court said:

> "Since the number of wells to be drilled on the land was not specified, there was an implied obligation on appellants to fully develop the land and *put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas.*"

It clearly appears that the court was not of the opinion that the defendant was obligated in all events to drill additional wells on the plaintiff's land, but was required only to drill such number of wells as were necessary to secure to the plaintiff his proportionate share of the pool of gas which the evidence disclosed underlaid his land and was being drained therefrom through wells on adjoining lands.

Day v. *Kansas City Pipe Line Co., supra,* was an action to cancel the undeveloped portion of a 600-acre lease by reason of the failure of the lessee to properly develop. Said lease required the lessee to drill 4 wells within 6 months and "*to continue drilling as long as paying wells were found or royalties were paid.*" The original lessee drilled and completed 4 wells on 80 acres of said premises within the first 6 months after said lease was executed. No further development was had for approximately 4 years, when the plaintiff filed his original petition. Subsequent to the filing of said petition, the lessee drilled 4 additional wells on another 80 acres of said lease, which produced oil in paying quantities, leaving the remainder of the 600 acres undeveloped. The trial court found that the lessee had not

exercised reasonable diligence in developing the premises in accordance with the aforesaid provisions of the lease and cancelled the lease as to all of the leased premises except the aforesaid 160 acres. There was no evidence that if additional wells had been drilled on the remainder of said premises oil or gas could not have been discovered therein in paying quantities, but the court simply held that under the aforesaid clause of the lease requiring the lessee to continue drilling as long as paying wells were found or royalties were paid the lessee was expressly obligated to drill additional wells. In its opinion the court does not attempt to define "reasonable diligence" in any case, but says that "what is due diligence is a question of fact which has been decided adversely to the contention of appellant." Said case is, therefore, no authority that drilling and producing oil in paying quantities from the two wells involved in the case at bar was not due diligence, in view of the uncontradicted evidence that oil or gas could not have been produced in paying quantities from any additional well or wells on the premises involved. The statement by the court that if paying wells could not be found on the land, or any part of it, there was no reason why appellant's title should be longer clouded with a barren encumbrance or any reason why appellant should resist cancellation, was *obiter dictum,* and certainly not binding upon the federal court.

Alford v. *Dennis, supra,* was an action to cancel an oil and gas lease in so far as it covered 220 acres of land belonging to the plaintiff. The original lease covered a tract containing some 936 acres, consisting of one tract of 716 acres and another tract some 2 miles distant therefrom, being the 220 acre tract in question. Subsequent to

the execution of the lease the ownership of the two tracts was separated. Said lease was for a period of 10 years and as much longer as gas or oil was produced in paying quantities, and provided that the lessee should begin operations thereunder within 6 months from the delivery of the lease, and complete 3 wells on said premises, and that no other or additional expense should be incurred under said lease by the lessee. 25 wells were drilled on the larger tract and the lessee paid royalties to the then owners thereof, but never at any time during the 13 years between the execution of the lease and the commencement of the action did any drilling on the smaller tract. The petition disclosed that there had been three separate and distinct oil booms in the vicinity and prayed for a cancellation of the lease insofar as it covered the aforesaid 220 acres. The lessee's demurrer to said petition was sustained by the trial court, from which ruling the lessor appealed. The opinion of the court recites that it was improvident for the owner to grant a lease on two large tracts for a long term without any requirements of exploration and development, but that it was not the province of the court to end a contract merely because it was a bad bargain. The court further stated that the petition narrated a predicament capable of some legal or equitable redress, not necessarily the redress prayed for by the plaintiff, and held that the case should be reversed and remanded to the trial court with directions to permit the issues to be joined and the facts determined and to allow plaintiff damages if they could be definitely ascertained, and in the alternative that the lessee be required to proceed in good faith to develop the premises within a reasonable time. Said opinion does not disclose that it was improbable

that oil or gas could be produced on said premises in paying quantities, and it is reasonable to assume, in view of the fact that the court required further development, that it was of the opinion that if such development was made oil or gas in paying quantities could be discovered. We are certainly not justified in assuming that there was any showing in the case that oil or gas in paying quantities could not be discovered, or that the court would have ordered the defendant to perform apparently useless acts. The court did say that unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease and that if the defendant had no bona fide intention to develop said tract to cancel the lease would do him no injury, but, as heretofore pointed out, the court refused to cancel said lease and said statement was *obiter dictum,* Said case is certainly no authority for the proposition that where there are producing wells on a lease and the evidence discloses that oil or gas probably would not be discovered in paying quantities on the remainder of the lease, the lessor is entitled to a cancellation as to the undeveloped portion of the lease.

Webb v. *Croft, supra,* was an action to cancel an oil and gas lease on several tracts of land, comprising 580 acres. The lease was for a term of 5 years and as long thereafter as oil or gas, or either of them, was produced therefrom. Said lease further provided that the lessee should complete a well within 12 months from the date of the lease or pay to the lessor $580.00 per year for each year drilling was delayed. There was no development until shortly prior to the expiration of the primary term of the lease, but a producing gas well was completed one day before the

expiration of the lease. The trial court found that the lease had not been sufficiently developed and decreed that there should be further development and provided in said decree what further development should be made and the time within which it should be made. From said decree the defendant appealed. The only justification offered by the defendant for its failure to drill any other or additional wells on the premises was that there was no market for more gas in the vicinity than was already being produced. There is no showing that oil or gas could not have been discovered in paying quantities had additional wells been drilled. Relying on and citing with approval *Howerton* v. *Kansas Natural Gas Company, supra,* and *Alford* v. *Dennis, supra,* the court said:

> "The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling.*"

Therefore, the forgoing case, rather than being an authority for the contention of the petitioners, is a direct authority for the contention of the respondent.

Clearly the court ordered further development under the justified assumption that oil or gas could be produced in paying quantities from additional wells.

McCarney v. *Freel, supra,* is the only Kansas case cited by the petitioners which is in the least contrary to the contention of the respondent. That case was an action to can-

cel on oil and gas mining lease which covered a quarter section of land, which said lease was for a term of 10 years and as much longer as oil or gas could be produced in paying quantities. Four months after the execution of the lease a well was drilled, which produced oil in paying quantities and continued to so produce until the time of the trial of said case. Five years thereafter a dry hole was drilled on said premises, and no further effort was made to develop the resources of the land. The trial court cancelled said lease, and, in affirming the action of the trial court, the Supreme Court said that the "plaintiff's evidence warranted the inference that defendants have not reasonably developed her land." Upon that theory alone the plaintiff was entitled to a cancellation of the lease on the undeveloped portion of the leased premises. The court, however, went on to say:

> "If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."

The opinion in said case covers less than a half page of the Pacific Reporter, and the court does not cite a single case in support of its conclusion. Said case is contrary to the prior Kansas decisions and directly contrary to the decision of the Kansas court in *Webb* v. *Croft, supra,* decided a few months prior to said case. We, therefore, earnestly insist that little or no weight should be attached to said case, and that since said case was decided long subsequent to the execution of the lease in the case at bar and is

contrary to the former decisions of the Kansas court, the decision in said case is not binding upon the federal court as establishing a rule of property.

Summarizing, none of the foregoing cases, with the exception of the *dictum* in *McCarney* v. *Freel, supra,* is authority for the petitioners' contention that there is an implied covenant in an oil and gas mining lease to further develop the premises under lease where the evidence discloses that oil or gas is being produced therefrom in paying quantities and further discloses that oil or gas could not be produced in paying quantities in any additional well or wells on said premises, and that no reasonably prudent operator would drill an additional well. On the contrary, said cases clearly establish that under a lease such as is involved in the case at bar the lessee is obligated to drill only such wells as a reasonably prudent operator would, under the circumstances, drill. It, therefore, follows that the decision of the Circuit Court of Appeals herein is not contrary to the Kansas decisions.

The Kansas cases require the plaintiff in an action to cancel an oil and gas lease for breach of an implied obligation to develop or further develop to show as a prerequisite to the right of cancellation that plaintiff's damages are not susceptible of measurement, and no such showing was made in the case at bar.

In the case of *Howerton* v. *Kansas Natural Gas Co.,* 81 Kan. 553, 108 Pac. 813, it was specifically held that in an action to cancel an oil and gas lease for failure to fully develop the leased premises the burden was upon the plaintiff to show that a remedy in damages was not an adequate

remedy and in the absence of such showing a decree for cancellation would not be sustained. In the case at ba no such showing was made or even attempted.

Contrary to petitioners' contention, an oil and gas lease in Kansas does not convey an interest in real estate.

In *Mills* v. *Hartz*, 27 Kan. 218, 94 Pac. 142, the court said:

> "*The lease is not a grant of land, nor of the oil, coal, or gas in the land.* It did not transfer any estate to Mills, and hence some of the rules which he invokes as to nonuser and abandonment do not apply. *Hartz granted him the possession of a part of the land with the right to search for minerals, and gave him an interest in so much of the minerals as might be found and taken out, but, if none were found, no interest in the undiscovered mineral could be acquired by him, and certainly no estate in the land.*"

In *Huston* v. *Cox*, 103 Kan. 73, 172 Pac. 992, cited by the petitioners, the court held:

> "A lease granting the right to enter on land and to explore for oil and gas, and if it be found in paying quantities to operate and produce, is not a lease in the strict sense, and creates no estate in the lands, but merely an 'incorporeal hereditament', which is a right growing out of, or concerning, or annexed to, a corporeal thing, but not the substance of the thing itself."

In *Robinson* v. *Smalley*, 102 Kan. 842, 171 Pac. 1155, cited by the petitioners, the court said:

> "While the court has held that an oil and gas lease of the kind under consideration does not constitute a conveyance, will not support a mechanic's lien, does not

operate as a grant and severance of mineral in place, *and creates no estate proper in the land itself*, it does create an incorporeal hereditament. A contract for the sale of hereditaments, whether incorporeal or corporeal, is within the sixth section of the statute of frauds. Gen. Stat. 1915, Sec. 4889."

In *Brinkman* v. *Empire Gas & Fuel Co.*, 120 Kan. 602, 245 Pac. 107, relied on by the petitioners, the court held:

"The grant was a grant of exclusive privilege for ten years to enter upon, operate for, and procure oil and gas on the described land—*a profit a' prendre.*"

Since none of the foregoing Kansas cases involved the precise facts involved in the case at bar, the Circuit Court of Appeals was not bound thereby.

As heretofore pointed out, in not a single one of the Kansas cases relied on by the petitioners did the evidence disclose that if additional wells had been drilled on the premises involved therein said wells would not have produced oil or gas in paying quantities, or that a reasonably prudent operator would not have drilled an additional well or wells thereon. Consequently, none of said cases involved the precise facts in the case at bar.

In *John Deere Plow Co.* v. *Mowry*, (6 C. C. A.) 222 Fed. 1, the court held:

"It is only to a settled rule of a state court applicable to the precise facts disclosed by the record that a federal court should yield its own judgment."

Since the lease involved herein was executed and the rights of the respondent accrued thereunder prior to the only Kansas case, to-wit: *McCarney v. Freel, supra,* which can be said to conflict with respondent's contention, the Circuit Court of Appeals was not required to follow said case.

The case of *McCarney* v. *Freel, supra,* was decided June 12, 1926, and the lease involved herein was executed on the 6th day of June, 1916.

In 25 Corpus Juris, at page 843, section 179, the following general rule is stated:

> "When contracts and transactions have been entered into and rights have accrued thereon under a particular state of the decisions, or when there has been no decision of the state tribunals, the federal courts will adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the state courts after such rights have accrued. * * *"

In the case of *Barton V. Kuhn* v. *Fairmont Coal Company,* 215 U. S. 348, 54 L. ed. 229, this court held as follows:

> "A decision of the highest state court that the grantor in a deed conveying the coal under a tract of land, with the right to excavate, and remove all of the coal, cannot maintain an action for damages in tort, founded upon the failure of the grantee or his successors to leave sufficient support to the overlying or surface land, is not binding upon the federal courts in a similar action based on almost identical facts and circumstances, the granting clause of the two deeds being in fact identical, where such decision was handed down after the deed upon which the defendant relies was executed, and after the injury complained of was sus-

tained, and the action begun, and where the point decided had not been previously adjudged by the state Supreme Court."

In the case of *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) 725 (10 C. C. A.), deciding the identical question involved herein, it was held:

> "Decisions construing oil leases decided after lease involved was executed *held* persuasive only."

In *Mothershead, State Bank Com'r of Oklahoma*, v. *United States Fidelity & Guaranty Co.*, 22 F. (2d) 644, (8 C. C. A.) it was held:

> "Decision rendered by the highest state court after rights and liabilities of parties under contracts involved in federal court suit have fully accrued is not binding on federal courts as a rule of decision."

In *Butte & Superior Copper Co.* v. *Clark-Montana Realty Co., et al.*, (9 C. C. A.) 248 Fed. 609, the court held:

> "Decisions of the Montana state court as to the validity of mining locations are not precedents binding on the federal courts in a suit involving the validity of locations in that state made prior to the rendition of such decisions of the Montana court."

The matter of construing an oil and gas lease is a matter of general law concerning which the federal courts will reach their own conclusion.

In the case of *Foxcroft* v. *Mallett*, 45 U. S. 353, 11 L. ed. 1008, this court held:

> "A decision of a state court upon the construction of a deed, as to matters and language belonging to the common law and not to any local statute, although entitled to high respect, is not conclusive upon this court."

Since the relief sought herein is wholly in equity, the Circuit Court of Appeals was not bound by any Kansas decisions.

The only question decided in the case at bar was whether the petitioners were entitled to the cancellation of the oil and gas lease involved herein by reason of the alleged failure of the respondent to properly comply with the implied covenants of said lease. This was purely an equitable question, depending for its decision upon the general principles of equity jurisprudence. And it is well established that federal courts are not bound to follow the decisions of state courts in cases depending upon general principles of equity jurisprudence.

In the case of *Lyon, et al.*, v. *Union Gas & Oil Co., et al.*, 274 Fed. 957, the United States District Court for the Eastern District of Kentucky held:

> "The decision of the state court that equity would enforce the forfeiture of an oil and gas lease for failure to develop after reasonable notice is one affecting the right to relief in equity, which is not binding on the federal court, especially where the decision was a *dictum*, and a statute had since been enacted establishing the contrary rule."

During the course of the opinion in said case, Judge Cochran said:

> "It seems to me that, if that doctrine is to prevail, it is decidedly questionable whether the notice given here was a reasonable one, only 3 months, and the lease contemplated an annual payment. It may be that, if that doctrine applies, there ought to be a year's notice. At any rate, the burden was on the plaintiff to show that that was a reasonable time, and it is extremely

doubtful, to say the least of it, whether or not they made out that a reasonable time had elapsed. However that may be, I do not think that I am controlled by the decision of the Kentucky Court of Appeals in the *Monarch* case. The Kentucky Court of Appeals has never actually applied that doctrine to a single solitary case. Never has a lease been forfeited by that court upon a notice requiring development. The statement of the Court of Appeals that a forfeiture can be brought about in this way is pure *dictum*. As stated, never yet has a case been decided by them where a lease has been declared forfeited upon a notice.

"Furthermore, I do not think that *dictum* is sound. According to the very terms of the lease, delay in development is authorized on the payment of the rental. For a court to forfeit a lease on failure to develop on notice is to change the contract of the parties. If the legislature were to pass a law saying or providing that in a lease of this character development might be hastened by giving notice, it would be in violation of the constitutional provisions that inhibits the legislature passing a law impairing the obligation of a contract. Then, in March, 1920, the legislature passed an act overthrowing that doctrine, saying that no lease could be forfeited in that way. So it is no longer a doctrine in Kentucky that a lease can be forfeited in that way. But I do not think that, if that statute had never been passed, I would be bound to follow that *dictum* of the Court of Appeals. All that is involved is a question of equitable relief. The Supreme Court of Illinois had held that it was not equitable to enforce a lease if if it had a surrender clause in it, and yet the Supreme Court of the United States, in the case of *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. ed. 856, decided that the federal court was not bound by that decision—that the federal court would enforce a lease containing a surrender clause—on the ground that it was a matter of relief in equity, and in a matter of that sort federal courts are not bound by state courts."

In the case of *Guffey* v. *Smith*, 237 U. S. 101, 59 L. ed. 856, Mr. Justice VAN DEVANTER, speaking for the court, said:

> "The Supreme Court of Illinois, while fully sustaining the right to maintain such a suit in the courts of the state when the lease contains no clause giving the lessee an option to surrender it (*Gillespie* v. *Fulton Oil & Gas Co., supra*), holds that the presence of such a clause in the lease operates to prevent the lessee from directly or indirectly enforcing it in equity (*Watford Oil & Gas Co.* v. *Shipman*, 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53, and *Ulrey* v. *Keith*, 237 Ill. 284, 298, 86 N. E. 696), the ground of distinction being that the surrender clause, although lawful in itself, and not affecting the validity of the lease, renders it so lacking in mutuality that equity will remit the lessee to his remedy at law. These decisions, it is insisted, should have been accepted and applied by the circuit court. To this we cannot assent. By the legislation of Congress and repeated decisions of this court it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting. Rev. Stat., Secs. 913, 917; Comp. Stat. 1913, Secs. 1536, 1543; *Neves* v. *Scott*, 13 How. 268, 272, 14 L. ed. 140, 142; *Payne* v. *Hook*, 7 Wall. 425, 430, 19 L. ed. 260; *Dodge* v. *Tulleys*, 144 U. S. 451, 457, 36 L. ed. 501, 503, 12 Sup. Ct. Rep. 728; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204, 37 L. ed. 1052, 1053, 14 Sup. Ct. Rep. 75. As was said in the first of these cases: 'Whenever a case in equity may arise and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this court in the last resort, to decide what those

principles are, and to apply such of them to each particular case as they may find justly applicable'."

In the case of *City of Dallas* v. *Higginbotham-Bailey-Logan Co.*, 37 F. (2d) 513, the Circuit Court of Appeals for the Fifth Circuit held:

> "A federal court siting in equity is not bound by decisions of state courts."

If the Kansas decisions are in conflict by reason of *McCarney v. Freel, supra,* or are not clear and definite upon the precise question involved herein, the Circuit Court of Appeals was not required to follow said decisions.

The above proposition is fully sustained by the case of *Concordia Ins. Co.* v. *School Dist.*, 282 U. S. 545, 75 L. ed. 528, in which this court said:

> "The general rule that a federal court will follow the decisions of the highest court of a state construing a state statute is, of course, well established. The difficulty here is that, prior to the judgment of the federal district court in this case allowing interest, the decisions of the Supreme Court of Oklahoma were in such confusion that the view of that court in respect to the meaning of the statute, as applied to the present case, could not definitely be determined."

The Circuit Court of Appeals did not err in holding that the evidence in the record herein failed to show a breach of any implied obligation of respondent's lease.

The petitioners argue that the Circuit Court of Appeals, conceding it was right on the law announced in its opinion herein, reached the wrong conclusion as to the facts established by the evidence. A sufficient answer to this

argument is that the Circuit Court of Appeals, as its opinion clearly discloses, reviewed the evidence critically and in detail and arrived at the inevitable conclusion that the respondent had breached none of its implied obligations under the lease involved herein. Therefore, a review and argument of the evidence is, in our opinion, unnecessary. That the evidence clearly and without any conflict establishes that respondent had not abandoned any part of the leased premises, that there was no reasonable probability of oil or gas in paying quantities being discovered in any additional well or wells upon said premises, that no reasonably prudent operator would have drilled an additional well or wells, and that respondent stood ready, willing and able to further develop said premises to the extent that further developments indicated was practical, is beyond the realm of controversy.

Conclusion.

The lease herein specifically provides that in the event the lessee discovers oil or gas in paying quantities, upon the leased premises, within ten years from the lease date, it shall continue in full force and effect, upon the whole of said premises—not any particular part thereof—as long thereafter as oil or gas, in paying quantities, is produced thereunder by the lessee. To limit the continuance of such a lease after discovery of oil or gas to any specific portion of the leased premises—whether the same be forty or a thousand acres—is to disregard plain and unequivocal language. No objection is made to the cancellation of such a lease where there has been a breach of either an express or an implied obligation of the lessee. Here it is not claimed that the respondent has violated any of its express obliga-

tions. The claim is that it has breached an implied obligation of its lease. And what is that implied obligation? Petioners answer, the obligation to diligently and reasonably develop the leased premises. Well sounding words, but what do they mean? Certainly what is diligent and reasonable development does not depend solely upon lapse of time, or upon the amount of acreage covered by the particular lease, disregarding entirely the cost of the development, the prospects of discovering oil or gas, the cost of producing same, or the market therefor, to say nothing of other factors always considered by a reasonably prudent operator before deciding to commence a well. But that is exactly what the contention of petitioners reduces itself to, and they would have the court believe that the Kansas decisions support them. Surely it can not be said that the parties to an oil and gas lease ever contemplated that, notwithstanding the lessee had at great expense, discovered oil or gas in paying quantities and was producing same, he was required, in order to continue his lease as to the undeveloped portion of the leased premises, to keep drilling wells, in spite of the fact that there was no reasonable probability of discovering oil or gas therein, and in spite of the fact that no reasonably prudent operator would drill such wells. Instead of this being reasonable development it is the very opposite—unreasonable development. The implied obligation invoked by petitioners simply does not exist.

Respectfully submitted,

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1933.

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, *ET AL., Petitioners,*

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION, *Respondent.*

BRIEF *on* BEHALF *of* RESPONDENT.

May It Please the Court:

This action was commenced in the District Court of Greenwood County, Kansas, by Philip Sauder against the respondent, seeking the cancellation of the undeveloped portion of an oil and gas mining lease covering 360 acres of land in said Greenwood County. Subsequent to the removal of said case to the federal court Philip Sauder died and the action was revived in the name of the petitioners herein, who are his sole and only heirs at law. The aforesaid lease was executed and delivered to respondent's predecessors in title on June 6, 1916, and contains the following provisions:

"That the said parties of the first part in consideration of the sum of $1.00 (One) Dollar, receipt of which is hereby acknowledged to them duly paid by the said parties of the second part, and of the covenants and agreements hereinafter contained on the part of the said parties of the second part, to be kept and performed, do hereby lease and let unto the said parties of the second part the exclusive right for ten years from date hereof, *and as long thereafter as oil or gas can be procured thereon in paying quantities,* to enter upon, operate for and procure oil and gas upon the following described premises, situated in Greenwood County, State of Kansas, to-wit, East 1/2 of Section 16, Town. 23, Range 13, acres 320. Southeast 1/4 of Southwest 1/4, Sec. 16, Town. 23, Range 13, acres 40.

* * * * * * *

"If oil or gas be found *on these premises* by said second parties, *all rights, benefits and obligations secured hereby* shall continue so long as either can be procured in paying quantities.

* * * * * * *

"In case no well be commenced on said premises within one year from date hereof, all rights and obligations secured under this contract shall cease upon notice in writing from the said first parties. *Provided, however,* that the said second parties shall have the right to continue this lease in force from year to year, until a well is drilled thereon, by paying at any time within ten days from date of the service of said notice, an annual rental of $1.00 per acre for said premises. Said rental to be deposited to the credit of said first parties in Citizens State Bank in Gridley, Kansas, payable quarterly in advance." (R. 6-7)

The petitioners concede that during the primary term of the aforesaid lease, or in other words, during the first ten years after its execution, the respondent or its predecessors in title completed two wells upon the southwest 40

acres of said lease, that oil was discovered in paying quantities in each of said wells, and that at all times since the completion of said wells they have produced oil in paying quantities and are still so producing. The first of said wells was completed on or about the 1st day of November, 1921, and the second on or about the 1st day of January, 1922. Other than the aforesaid wells there has been no development upon the leased premises (R. 16, 30).

Primary Question Involved Herein.

The primary question herein is whether, under the evidence and the lease sought to be cancelled, there was any implied obligation upon the part of respondent to drill an additional well or wells upon the leased premises.

Importance of Question Involved Herein.

Two facts, *first,* the universal rule that an oil and gas lessee is not unconditionally required to drill an exploratory well at every location upon the leased premises, but is only required to drill such wells as an ordinary prudent operator, under all the circumstances, would drill, and, *second,* that due to the reliance of such lessees upon such universal rule it has been unusual to drill an exploratory well at every location upon even a producing lease, combine to render the decision of this court in the case at bar of unusual importance to the oil and gas industry.

In this day of enforced conservation of oil and gas, two of our great natural resources, the adoption by this court of the rule contended for by the petitioners would be deplorable, since such a rule would require the drilling of an unprecedented number of wells, which, if successful, would

result in augmenting the already over-production of oil and gas, and, if unsuccessful, would result in a foolish waste of money.

Petitioners' Amended Petition.

The only allegations contained in the petitioners' amended petition which in anywise allege a breach of the respondent's implied obligation to further develop the premises covered by its oil and gas lease are as follows:

> "* * * That from the oil wells upon adjacent land, although none are closer than four hundred feet from plaintiffs' line, several are close enough, that plaintiffs are informed and verily believe, and therefore allege, *that there is grave danger that oil deposits, if any, under the land of these plaintiffs, will be drawn off or depleted by the pumping of oil upon adjacent land;* that said oil production upon adjacent land has been going on for a number of years and that no new wells have been drilled upon said adjacent land since the year 1922.
>
> "Plaintiffs further allege and show the court that under the terms of said leases it was the duty of the holders thereof and especially of the defendant, Mid-Continent Petroleum Corporation, to fully explore and develop said lands for oil and gas, and plaintiffs allege that during the past years and ever since June 6, 1916, the said defendant, Mid-Continent Petroleum Corporation, and all of the parties to whom said lease may have been assigned, have wholly failed, refused and neglected to develop said land for oil and gas with the single exception of the two wells hereinbefore mentioned on the Southeast Quarter of the Southwest Quarter of said Section 16 and adjacent to the southwest corner of said half section herein described belonging to plaintiffs; that no effort whatever has been made to explore the east half of said Section 16; that the said

defendant, Mid-Continent Petroleum Corporation, although repeatedly requested and demanded so to do, as hereinbefore stated, has wholly refused, and failed to further develop said land for gas and oil.

"Plaintiffs further allege that since the year 1922, at least, the development of oil upon land adjacent to the land described herein belonging to plaintiffs has made it *practically certain that oil could have been discovered in paying quantities by the drilling of wells upon said East Half of said Section 16,* but that notwithstanding said fact, the said defendant, Mid-Continent Petroleum Corporation, has refused to develop said land and has held the same for speculative purposes and that by reason of such refusal said defendant, Mid-Continent Petroleum Corporation, in equity and good conscience, has forfeited its right to further hold said lease and should be by this court adjudged and decreed to be wholly in default of its obligations under the terms of said lease, and that said lease should be by the court cancelled, set aside and held for naught as to all of said land described herein, with the possible exception of land immediately adjacent to the two wells heretofore described lying and situate in the south part of the Southeast Quarter of the Southwest Quarter of said Section 16." (R. 19-20)

The prayer of said amended petition is as follows:

"*Wherefore,* the premises considered, plaintiffs pray for a judgment and decree of this honorable court, cancelling said lease and that said lease be cancelled, set aside and held for naught as to all of said lands, except such portion of said Southeast Quarter of the Southwest Quarter of Section 16, immediately adjacent to said two wells described in the petition herein, as the court may designate and plaintiffs pray that they have such other, further and additional relief as they may be entitled to receive in equity and good conscience, including their costs herein expended." (R. 20)

Petitioners' counsel, in drafting the foregoing petition, obviously understood that in order to justify the cancellation of the lease involved the evidence would have to establish two things, or at least one of them, to-wit: *(1)* That oil was being drained from under the lands involved by wells on adjacent premises; and, *(2)* that it was "practically certain" that oil could be "discovered in paying quantities by the drilling" of additional wells upon the premises involved. However, the petitioners wholly failed to prove either of these things, and the respondent overwhelmingly proved the very opposite.

Respondent's Answer.

The respondent in its answer admitted the drilling of the two aforesaid wells; that oil in paying quantities was discovered in each of said wells; that said wells had at all times produced, and were still producing, oil in paying quantities; and that it had not drilled any other well or wells on the leased premises. It further admitted that there were producing oil wells in the immediate vicinity of the lands covered by its lease, but denied that any of said wells was within 400 feet of the boundary line of said land, except certain wells offsetting the two wells on its lease. It denied that any of the wells in the vicinity of petitioners' lands were draining, had ever drained or were likely to drain any of the oil or gas from beneath said lands, and alleged that it and its predecessors in title had complied with all of the express and implied terms, covenants and provisions of its lease and that said lease was a good, valid and subsisting lease on the lands involved herein, and each and every part thereof. Respondent further alleged that it had

properly offset the wells upon the premises adjoining the lands involved herein, which it was required to offset under either the express or implied terms of its lease, and that it had drilled as many wells on the leased premises as under the circumstances would be reasonably expected of operators of ordinary prudence (R. 20-24).

Petitioners' Evidence.

The petitioners introduced no evidence whatsoever that if the respondent had drilled any additional well or wells upon the lands involved herein it would probably have discovered oil or gas in paying quantities, that is, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, or that a reasonably prudent oil operator would have drilled any additional well or wells, or that any of the wells on adjoining property had drained, was draining or was likely to drain any oil or gas from under the lands involved herein.

In his opening statement to the court counsel for petitioners made the following statement: "*However, the evidence also shows that in this field there are spots where there is oil and also spots where there is no oil and it is a field where it is impossible to tell whether a development of this lease would have yielded profits or would not and it is one of those cases where it is impossible to establish by geology because it is too speculative and the only resort we have is to cancel the lease.*" (R. 45)

The petitioners introduced in evidence their Exhibit No. 1, which was a map prepared by the respondent, and

which showed the location of the wells upon the lands involved herein, and upon the premises adjacent thereto, the date of the completion of each of said wells, the depth to which each well was drilled, and the initial production, if any, from each of said wells (R. 66A). Said map did not show, nor did the petitioners introduce any evidence to show whether or not said wells on adjoining premises produced oil or gas in paying quantities—or the amount of production required to constitute oil in paying quantities.

It was stipulated by and between the parties that the total of the one-eighth royalty paid by the respondent under the lease involved herein from 1927 to the date of trial was $760.50 for the year 1927, $658.45 for the year 1928, $623.90 for the year 1929, $495.45 for the year 1930, $239.23 for the year 1931, and for the year 1932 up to the date of trial an average of $21 or $22 per month (R. 46).

It was stipulated that respondent's Exhibits A, B and C, appearing at pages 67, 68 and 69 of the record, might be considered in evidence, and that they were substantially correct statements of the amount of oil and water which was then being produced from each of the wells upon the lands involved herein and the lands adjacent thereto; that said figures represented the daily average for approximately fifteen days prior to the date of said statements, and that there was a well being drilled at the time of the trial of the case at bar one-half mile north and 700 feet east of the east line of the petitioners' lands and that said well was down at the time about 1100 feet (R. 46-47).

In the course of the introduction of petitioners' evidence their counsel stated to the court: "The evidence will show, if you want it, that all this field in Greenwood Coun-

ty, that the production after three or four years goes down very rapidly." (R. 46)

The above and foregoing is all of the evidence introduced by the petitioners on the trial of the case at bar.

Respondent's Evidence.

Although the petitioners' evidence was undoubtedly wholly insufficient to entitle them to any relief whatsoever, the respondent produced four witnesses, each of whom qualified as an expert oil man with many years' experience in the development and operation of lands for oil and gas, and who were familiar, not only with the premises involved herein, but also with the lands in the vicinity thereof, and each of said witnesses testified that in his opinion it would not have been profitable for the respondent to have drilled any additional well or wells upon the premises involved herein and gave in detail his reasons for such opinion.

GEORGE O. MOODY, vice-president in charge of production of oil and gas for the respondent, testified that he had been engaged in the oil and gas business for about thirty-two (32) years, and that he had been engaged in such business in Kansas and Oklahoma continuously since 1916; that he was familiar with the lease involved herein; that the total revenue from oil produced from said lease from the time the wells thereon were drilled to December 31, 1931, was $72,694.18; that the royalty paid to the lessors in said lease was between $9,000 and $10,000; that the total expenditures in connection with the development and operation of said lease was $46,464.97; that said lease had shown a profit to the respondent of only approximately 5.1% per annum, which was a very small return for an oil

venture considering the large expenditures required and the great hazards involved; that respondent owned several leases covering lands adjacent to petitioners' land, but inasmuch as it had purchased all of said leases after they had been producing for some considerable time, except its Viola M. Griblin-A lease, it did not have the figures to show the revenue and expenditures in connection therewith; that its Viola M. Griblin-A lease had shown a profit to respondent of only approximately 6.8% per annum; that the wells located along the east line of the lease involved herein, shown on petitioners' Exhibit No. 1, were producing from two geological stratas, one called the Bartlesville sand and the other the Mississippi lime, and that the major portion of said wells were producing from the Bartlesville sand; that none of the wells to the east of the leases involved herein was drilled any closer than 660 feet to the east line of the premises involved herein because as they went west with the locations the oil decreased in volume and the water increased, showing that they were reaching the edge of the pool; that the development to the east demonstrated that the Bartlesville sand played out before it reached the east line of the lease involved; that in his opinion by going west one location from any of the wells east of said lease one would get a dry hole; that Shaffer & Howell owned the lease covering the Northwest Quarter (NW4) of Section 15, Township 23, Range 13, immediately east of the premises involved herein, and that the respondent herein had no interest whatever in said lease; that the closest well on said lease to the east line of the lease involved herein was well No. 4, which was 660 feet from said line, and that there was sufficient distance between that well and the east line of

the lease involved to have drilled an additional well; that the same thing was also true of all the wells located along the west side of the Shaffer & Howell lease, and that all of the other wells along the west side of the Shaffer & Howell lease were a greater distance from the east line of the lease involved than said well No. 4; that well No. 2 on the Theta Oil Company lease covering the Southeast Quarter (SE4) of Section 9, which lease adjoins the premises involved herein on the north, shown on petitioners' Exhibit No. 1, was a dry hole; that said well was drilled below where the Bartlesville sand was ordinarily encountered in this locality and was drilled below where oil in the Mississippi lime was ordinarily encountered in this locality; that no production was obtained in said well in either the Bartlesville sand or the Mississippi lime; that the well on the Northeast Quarter (NE4) of Section 21 south of the Theta well No. 2, being well No. 1 on the Viola M. Griblin-B lease, which said lease adjoined the premises involved herein on the south, was drilled through the Bartlesville sand to the Mississippi lime, and that the Bartlesville sand encountered was very broken and in a small amount, that no production was obtained in said sand, and only a very small amount of production was obtained in the Mississippi lime; that said well had not produced oil in sufficient quantities to pay the cost and expense of drilling and equipping it, and probably never would pay out; that the Theta well No. 2 and the Viola M. Griblin-B well No. 1, which are in a direct north and south line, tend to show that the probabilities are that there was no Bartlesville sand under the lease involved herein; that the respondent drilled well No. 1, on the Viola M. Griblin-B lease because there was a large undeveloped area be-

tween the two pools and that it went between the two pools to see whether or not there was any connection or production between them, and that said well No. 1 on the Viola M. Griblin-B lease showed there was not enough oil to pay; that said well and the history of it had a great deal to do with the respondent not having drilled additional wells on the lease involved; that the two aforesaid wells tended to prove that there was either no oil or oil in too small quantities to pay in the Mississippi lime under the lease involved; that taking into consideration the facts shown on the map introduced in evidence as petitioners' Exhibit No. 1, in his opinion the sand from which the wells east of the lease involved were producing, like the sand in all oil producing areas in that part of Kansas, was a long narrow strip, that one usually got better results by drilling in the middle of that line of sand and that by going either east or west from the middle the wells were usually smaller; that all of the wells to the west of the premises involved herein were producing from the Mississippi lime, but all of said wells were drilled through the Bartlesville sand or where the Bartlesville sand is ordinarily encountered, and that none of said wells ever produced from the Bartlesville sand; that well No. 1, on the premises involved herein was located in the extreme southwest corner of said premises, and that the initial production of said well was approximately 75 barrels; that well No. 2 on the premises involved was to the east of well No. 1 and that the initial production of said well was approximately 20 barrels; that that indicated that if the respondent had extended development further east on the premises involved it would have gotten a dry hole; that taking into consideration the development

both upon the lease involved herein and upon all the surrounding leases, both east and west and north and south, the cost of drilling and equipping a well in that locality and the probability of encountering paying production, and all other available facts, it was his opinion that no prudent operator would have drilled another well on the premises involved; that the respondent had never abandoned or intended to abandon any portion of its lease; that if the future should prove it practical to drill another well on said lease respondent was capable and willing to drill it; that there was a dry hole on the Florence Oil Company lease to the west of the lease involved, just one location therefrom; that said well was drilled to the Mississippi lime and through where the Bartlesville sand should have been encountered; that there was a dry hole drilled on the East Half (E2) of the Northwest Quarter (NW4) of Section 16 by the Syndicate Oil Company, and that said well was drilled through where the Bartlesville sand should have been to the Mississippi lime, and that said well was a little more than one location from the lease involved; that said wells indicated that it was improbable that oil could be obtained on the lease involved; that oil was discovered in paying quantities in each of the two wells drilled on the lease involved and that said wells had been continuously operated down to the present time and were still being operated; that said wells had at all times produced, and were at the time of the trial producing oil in sufficient quantities to produce a profit over and above the cost of operation; that none of the wells located to the east of the lease involved was what is known as an "offset" well, and that the usual location distance from the line for wells in this

vicinity was approximately 200 feet; that the usual distance between wells was approximately 500 feet or a little more, and that none of the wells drilled along the east line of the lease involved was within 500 feet of the east line of said lease; and that there was sufficient space for the location of another well between each of said wells and the east line of said lease (R. 47-54).

LLOYD SNYDER testified that he had charge of the operation of the lease involved and that he had been superintendent of production for the respondent in this particular locality for thirteen years; that he had been engaged in drilling and operating oil wells for about 33 years; that he was familiar with the wells which had been drilled to the east of the lease involved and that said wells were not close enough to the lease involved to be what are commonly called "offset" wells to said lease; that the closest producing well to the east line of said lease was well No. 4 on the Shaffer & Howell lease and it was 660 feet from the east line of the lease involved; that the usual distance between wells in the locality of the lease involved was 460 feet, staying 200 feet from county lines and lease lines; that the wells to the east of the lease involved were producing from the Bartlesville sand and that the wells to the west and southwest of said lease were producing from the first break in the Mississippi lime, which was below the Bartlesville sand; that the respondent herein owns a lease on the Southwest Quarter (SW4) of Section 15, the Shadel lease, and that the respondent had not extended its development further west on said lease because in his opinion no prudent operator would have developed it further west and that he based his opinion upon the water encroachment and the thickness

of the sand; that in drilling the wells on said lease as they went further west on the shoe string line of sand they developed more water and that was an indication that the producing sand was playing out; that in his opinion it would not have been profitable to have drilled an additional well on any portion of the premises involved herein and that if additional wells had been drilled on said lease oil or gas would not have been discovered in such quantities as to have paid the cost of drilling, together with a reasonable profit on that outlay, and that in his opinion no prudent operator would have drilled an additional well on said lease; that well No. 1 on the lease involved showed an initial production of 75 barrels and a certain thickness of sand; that well No. 2 to the east of said well No. 1 showed a thin sand and a very small amount of oil and from these facts he reached the conclusion that if they had gone further east they would have gotten the lime and it would have been non-productive; that the well on the Viola M. Griblin-B lease in the Northeast Quarter (NE4) of Section 21, was drilled through the Bartlesville sand into the Mississippi lime; that it did not produce oil in paying quantities and that in his opinion it would never pay out; that the well immediately north of said well on the Theta Oil Company lease covering the Southeast Quarter (SE4) of Section 9 was a dry hole and that said well was drilled through the Bartlesville sand into the Mississippi lime; that the aforesaid two wells had a tendency to show that the lime oil did not extend that far west on the lease involved and that the sand was missing in both of said wells; that said wells showed that in that direct line north and south oil could not be found in paying quantities, either in the Bartlesville

sand or in the Mississippi lime; that there were no "offsets" to the lease involved, except the two wells on the Griblin-A lease and the Florence Oil Company lease, which had been offset by the respondent; that in his opinion it would not have been a prudent idea to have drilled any other "offset" well to the lease involved; that Shaffer & Howell owned the lease to the north of the Shadel lease, which said lease adjoined the lease involved on the east, and that they had laid back from the line of the lease involved about 660 feet; that the respondent and Shaffer & Howell did not have and never talked of any agreement to lay back from the line and not give Mr. Sauder an offset well; that Shaffer & Howell used the same theory that prudent operators would use; that the respondent did not drill a well to the north of well No. 1 on the lease involved because it would have been an offset to a dry hole; that from a geologist's point of view, the apparent trend, which came toward the lease involved from the southwest, seemed to stop before it reached the lease involved; that he did not think that the wells surrounding the lease involved that had been pumping from 8 to 11 years were draining oil from under the lease involved; that he did not think there was any producing sand under the lease involved, but that even if there was oil under said lease, from the location of the wells on adjoining premises said wells would not drain the oil from underneath the lease involved; that the wells around the lease involved might possibly lower the pressure; that whether or not drilling an "offset" to a producing well would lower the production of the producing well depended upon the body of sand it was producing from and whether it was a small body of sand or a large one; that he would consider the body of

sand to the east of the lease involved a very small body of sand; that he did not consider the respondent had been draining oil from under the lease involved; that for perfect drainage wells were placed 460 feet apart and 200 feet from the lease lines, and that there had been no wells drilled on adjoining property that would drain the lease involved; that in the 33 years he had been engaged in the oil business he had never heard of any oil field in which the producing sand did not at some place play out and that he had never heard of any oil sand that did not have definite limits; that the wells to the southwest of the lease involved were producing from the Mississippi lime and that in drilling said wells no Bartlesville sand was found; that some of the wells to the northeast of the lease involved were producing from the Bartlesville sand and some from the Mississippi lime; and that there was nothing to indicate any connection between the wells to the southwest and those to the northeast of the involved lease (R. 54-59).

L. J. YOUNG, a graduate of geology at the University of Michigan, testified that he had been employed as a geologist by the respondent for 10 years; that he had personally examined the logs of the wells that had been drilled in the immediate vicinity of the lands involved herein; that he had prepared a map or chart, respondent's Exhibit D, which appears at page 73 of the record, showing the location and trend of the sand from which the wells to the east and to the northeast and to the southeast of the lease involved were producing; that said map was prepared from the logs of wells drilled in the vicinity of the lands involved herein; that the general direction of this sand was just a little east of north and that it was very narrow; that the

red lines on said map extending through the middle of the black lines indicate the crest or highest point at which the drillers found the sand in drilling the wells, and that in going either east or west from said red lines the sand is encountered at lower depths and that it showed a dip on the top of the Bartlesville sand, both to the east and to the west, from the center line; that the best wells were along the center line and that they decreased on each side as you went either east or west; that in his opinion, based upon an examination of the logs of the wells, the sand did not extend as far west as the lease involved; that he had indicated the lease involved on said Exhibit D by green pencil marks; that he had also prepared a map or chart showing the location and trend of the Mississippi lime in the locality of the involved lease, which was introduced in evidence as respondent's Exhibit E and appears in the record at page 77; that the black lines on said map were the contour lines on the top of the Mississippi lime and that the map was prepared for the purpose of showing the subsurface condition, particularly with reference to the Mississippi lime, in the locality of the lease involved; that said map was prepared from the logs of the wells drilled in the vicinity; that the lease involved was shown on said map in green crayon; that he had also shown the location and trend of the Bartlesville sand on said map by drawing two red lines and that the production from the Bartlesville sand was within those lines. Referring to wells Nos. 1 and 2 on the lease involved and well No. 1 on the Florence Oil Company lease to the west of the lease involved, the map showed a dip of 15 feet on the top of the Mississippi lime between those three wells, going down toward the east or

toward well No. 2 on the lease involved; that the dry hole on the Florence Oil Company lease on the Southeast Quarter (SE4) of the Northwest Quarter (NW4) of Section 16 was 32 feet lower on the top of the Mississippi lime than well No. 1 on the lease involved; that the lime under the lease involved was low and that it dipped in every direction except from the northwest to the southeast; that the production from the Mississippi lime was obtained where the lime was encountered at high points and the dry holes were obtained where the lime was encountered at low points; that in his opinion no paying production could be obtained from the Mississippi lime at any point on the lease involved other than at the location of the two wells that had been drilled on said lease because the lease lies too low on the top of the Mississippi lime for production; that he could not see any reason for thinking there was any oil at all on the lease involved; that the Bartlesville sand did not extend far enough to the west to come to said lease; and that there was nothing to indicate that there was a trend in the Mississippi lime under said lease (R. 59-63).

S. V. BROWN, superintendent of the Shaffer & Howell Drilling Company, which owned the lease covering the Northwest Quarter (NW4) of Section 15, adjoining the lease involved on the east, testified that he had been superintendent of the Shaffer & Howell Drilling Company for a little more than 10 years; that he had drilled all of the 15 wells on that lease with the exception of two and that he had drilled quite a number of wells to the north of the lease involved; that he had charge of the operation of the wells on the Shaffer & Howell lease and had determined the location for all of the wells on said lease, with the exception

of the first four wells; that well No. 4 on said lease was the closest well to the east line of the lease involved; that it was located in the northwest corner of the Shaffer & Howell lease; that it had an initial production of 60 barrels; that he did not know whether or not said well had paid out; that none of the wells located on said lease was an "offset" to the lease involved; that the regular offset distance in this field was 200 feet from the property line; that there was room for approximately five or six locations along the west side of the Shaffer & Howell lease that had not been drilled for the reason that the Bartlesville sand did not extend to said locations; that the Theta Oil Company well in Section 9 proved that the Bartlesville sand did not extend far enough to the west to justify the drilling of those locations; that the trend of the sand on the Shaffer & Howell lease ran from the southeast to the northwest and that in his opinion there was no Bartlesville sand under the lease involved; that it would be necessary to find lime oil under the lands involved in larger quantities than he had found it on the Shaffer & Howell lease to pay for the drilling of a well; that in his opinion a reasonably prudent oil man would not drill an additional well on the lease involved; that the closest he had ever drilled to the lease involved was 660 feet from the east line; and that there was no agreement of any kind between Shaffer & Howell and the respondent (R. 64-65).

Each of the respondent's aforesaid witnesses frankly admitted that he might be mistaken in his opinion that oil in paying quantities could not be discovered in any additional well upon petitioners' land, and that he was simply giving his opinion based upon the past developments. And

said witnesses further testified that future developments around the northwest corner of said lands might justify the drilling of additional wells thereon (R. 52, 56, 62).

The foregoing uncontradicted evidence of the respondent conclusively establishes that the wells on the premises adjoining the lease involved herein have not drained, were not draining and were not likely to drain oil from under said lease; that if any additional well or wells had been drilled on said lease said wells would probably not have produced oil or gas in paying quantities, or, in other words, in sufficient quantities to have repaid the cost of drilling, equipping and operating such well or wells, together with a reasonable profit on the entire outlay, and that a reasonably prudent operator would not have drilled any additional well or wells upon said lease.

Petitioners' Request for Findings of Fact and Conclusions of Law.

The facts which the petitioners requested the trial court to find were not only insufficient to entitle them to any of the relief prayed for herein, but were such as to require said court to decide the case in favor of the respondent. For instance, the petitioners introduced no evidence as to drainage of oil from their lands by reason of wells on adjoining premises, but the respondent did, and the petitioners requested the trial court to find, which it did, that "the defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from plaintiffs' land," and further requested the trial court to find, which it did, that "this evi-

dence as to drainage is not wholly convincing to the court." Then, again, the petitioners contended, without introducing any evidence to that effect, that there was a well defined "trend" of oil producing sand and lime extending in a southwesterly-northeasterly direction under their land, and they requested the trial court to find, which it did, that "expert evidence introduced by the defendant tended to prove that no such 'trend' exists under and across the land described in said lease, but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said land, as estimated by geologists, is so great that the probabilities are no oil would be found in it. On this point the court is unable to determine the facts; but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive tests by drilling upon said land can settle the controversy as to whether oil or gas in paying quantities can be found upon said land." Furthermore, the petitioners did not request the trial court to find, nor did it find, that a reasonably prudent operator under the circumstances would have drilled any additional well upon the lands involved herein.

The Trial Court's Memorandum Decision.

At the conclusion of the trial, the trial court took the case under advisement, and subsequently filed herein its memorandum decision, which we presume was intended to embody said court's findings of fact and conclusions of law, as required by Equity Rule 70½, although the same is obviously not in the form contemplated by said rule. The pertinent facts found by the trial court in said memorandum

decision, and which are identical with the petitioners' request for findings of fact, are as follows:

"That within ten (10) years from the date of the execution, acknowledgment and delivery of the aforesaid oil and gas mining lease the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, drilled and completed two oil wells upon the above described real estate and premises, and that such wells were drilled as offsets to wells drilled and producing oil on an adjacent leasehold. Said two oil wells were drilled in the southwest quarter of the southeast quarter of the southwest quarter of said Section Sixteen (16) and at the extreme southwest corner of said leasehold; *that oil was discovered in each of said wells in paying quantities; and that at all times subsequent to the drilling and completion of said two wells the defendant, Mid-Continent Petroleum Corporation, or its predecessors in title, have produced oil in paying quantities from each of said wells; and said defendant, Mid-Continent Petroleum Corporation, is now producing oil in small but paying quantities from each of said wells.*

"That there has been oil development on lands adjacent to the real estate herein described, and that there are now and since about 1921 and 1922 have been many producing oil wells to the east and south bordering upon the real estate herein described, and to the southwest and the northeast on lands cornering with the land immediately east of the half section described in said lease there are approximately twenty-five producing oil wells; that upon the half section of land lying immediately south of said section there are approximately fifteen producing oil wells; that upon the quarter section cornering with the half section described in the lease to the south and east thereof there are approximately twelve producing oil wells; that west from the two offset wells drilled by the defendant upon the land described in said lease and upon the southwest quarter of said Section 16 there are three producing

oil wells; that on the half section cornering with the half section described in the lease to the northeast there is considerable oil production, but the record does not show the exact amount thereof; that directly north of said Section 16, but at considerable distance, there is oil production, but the evidence does not show the extent thereof.

"None of the oil wells referred to in the above finding are within four hundred feet of the property line of the land described in the lease with the exception of wells to the south which have been offset by the two wells drilled upon this property. *The defendant introduced the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from the plaintiff's land.* These witnesses, however, admitted that they might be mistaken as there was no absolute way of determining the question of drainage except by drilling tests. *This evidence as to drainage is not wholly convincing to the court.* There is, in the opinion of the court, some probability that damage is being done to this leasehold by drainage upon the adjoining properties.

"The defendant owns and is operating an oil lease on the south half of the half section lying immediately east of Section Sixteen (16) and the lease on the land cornering upon the south half of Section Sixteen (16) on the southeast, and the lease on the land on the south of said southeast quarter of the southwest quarter of said Section Sixteen (16) hereinbefore described.

"On the basis of the oil development and oil production upon adjacent lands, as shown by the evidence herein, plaintiffs contend that a well-defined 'trend' of oil producing sand and lime runs in a southwesterly-northeasterly direction under and across the land described in said lease. *Expert evidence introduced by the defendant tended to prove that no such 'trend' exists under and across the land described in said lease,*

but that on the contrary the oil sand is not to be found under said land and the depth of the lime under said land, as estimated by geologists, is so great that the probabilities are n oil would be found in it. On this point the court is unable to determine the facts but finds that no positive evidence having been introduced by either party as to this contention of plaintiffs, that nothing but exploration and positive test by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found upon said land. Neither the defendant nor any of its predecessors in title have drilled any well upon the east half of Section Sixteen (16) but no dry well has been drilled on any of the property covered by said lease." (R. 33-35)

It will be noted that the trial court nowhere found that there was any drainage from under the lands of the petitioners or that a reasonably prudent operator under the existing circumstances would have drilled any additional well upon said lands.

The Trial Court's Decrees.

On the 14th day of September, 1932, the trial court entered its decree cancelling respondent's lease, except insofar as it covered the premises upon which the two wells were located and a small portion of the premises surrounding said wells. And thereafter, on the 7th day of October, 1932, said court entered a second decree, which is identical with its aforesaid first decree, except that the respondent was permitted to leave upon the cancelled portion of its lease certain of its tanks, pipes and equipment used in connection with the operation of the two aforesaid wells, until such time as the location of said tanks, pipes and equipment should interfere with the operation and development

of the cancelled portion of said lease for oil and gas (R. 40-43).

Opinion of Circuit Court of Appeals.

In 67 F. (2d) 9, the Tenth Circuit Court of Appeals, Judge McDermott dissenting, reversed the above decree of the District Court, and the case is before this Court upon a writ of *certiorari*.

Petitioners' Contention.

In its final analysis petitioners' contention is that the lease involved herein imposed upon respondent an implied obligation to drill an additional well or wells upon the leased premises, notwithstanding the uncontradicted evidence herein that there was no reasonable probability that oil or gas in paying quantities would have been discovered therein, and notwithstanding the uncontradicted evidence that no reasonably prudent operator would have drilled such additional well or wells. In short, their contention is not that respondent was required to reasonably develop, but was required to unreasonably develop the premises herein.

While the petitioners say that the respondent was obligated to "diligently develop" the premises involved, it will be noted that they have wholly failed to lay down any test or standard for determining what is reasonable or diligent development. How many wells must be drilled? Where are they to be located? When are they to be drilled? Must a well be drilled at every location? How are the locations to be ascertained and determined? How deep is each well to be drilled? Who is to determine each of these things?

And upon what facts and circumstances or standard is the determination to be made? The petitioners answer none of these questions.

Respondent's Contention.

Respondent contends that its lease does not impose upon it any implied obligation to drill an additional well or wells upon the leased premises, in the absence of an affirmative showing that, under all the existing circumstances, there was a reasonable probability that oil or gas, in paying quantities, would have been discovered therein, or that a reasonably prudent operator would have drilled such additional well or wells.

The leading case of *Brewster* v. *Lanyon Zinc Co.*, (8 C. C. A.) 140 Fed. 801, which is a Kansas case, involving a lease on lands situated in Allen County, Kansas, sets forth clearly the tests for determining whether a breach of an implied covenant to drill oil or gas wells has been committed. In that case, as in the case at bar, the court was considering an implied covenant to continue exploration and development after the expiration of the fixed period of development, during which oil or gas had been found to exist in paying quantities. In said case Mr. Justice VAN DEVANTER, delivering the opinion of the Court, said:

> "Considering the migratory nature of oil and gas, and the danger of their being drawn off through wells on other lands if the field should become fully developed, all of which must have been in the minds of the parties, it is manifest that the terms of the lease contemplated action and diligence on the part of the lessee. There could not well have been an express stipulation as to the number of wells to be drilled, as to when

the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was, therefore, rationally left to the implication, necessarily arising in the absence of express stipulation, that such further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the controlling intention of the parties as manifested in the lease which was to make the extraction of oil and gas from the premises of mutual advantage and profit. * * *

"But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that the lessee must bear the loss if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them. It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local mar

ket or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir— whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required. A plain and substantial disregard of this requirement constitutes a breach of the covenants for the exercise of reasonable diligence, which, as before shown, is also made a condition of the lease under consideration."

The defendant in the foregoing case took the position that there was no implied obligation, regardless of circumstances, to further develop after its discovery of gas in paying quantities. In the case at bar, however, the respondent concedes that, under various circumstances, there is such an obligation but contends that the evidence herein completely negatives the existence of any circumstances giving rise to same.

The foregoing case involved the action of the trial court in sustaining the defendant's demurrer to the plaintiffs' petition, and Mr. Justice VAN DEVANTER, after enumerating the allegations of said petition, said:

"*The necessary inference from what is stated is that further exploration and development would have been profitable to the lessee, as well as beneficial to the lessor.* In these circumstances the prolonged failure of the lessee to proceed with the contemplated operations, though due to a mistaken view of the obligations imposed by the lease, was a plain and substantial breach of the covenant and condition in respect of the exercise of reasonable diligence and entitled the lessor to terminate the lease."

And, in concluding the opinion, Mr. Justice VAN DEVANTER said:

> "It follows that, under the rule before stated, the lessor will be entitled to relief *only* in the event that the case made upon the hearing shall be, as is that made by the amended bill, one the equity of which is strong enough to overcome the general indisposition of courts of chancery towards aiding in the enforcement of forfeitures."

The lease in the foregoing case covered three non-contiguous tracts—separated from eight to fourteen miles—yet the Court clearly held that the one well, drilled on one of said tracts within the primary term of the lease, was sufficient to hold the entire leased premises, unless there had been a breach of the implied obligation to further develop. In this connection Mr. Justice VAN DEVANTER said:

> "The further position is taken in the bill that the lessor was entitled to avoid the lease, because it covers three tracts separated by distances of from 8 to 14 miles, and because no well was drilled on two of the tracts within five years. That is a matter in respect of which it was competent for the parties to stipulate, and in respect of which they did stipulate, as shown by the following clauses of the lease:
>
> '(7) Second party (the lessor) agrees to drill a well upon said premises within two years from this date, or thereafter pay to first party (the lessor) seventy-eight dollars annually until said well is drilled, or the property hereby granted is conveyed to the first party.'
>
> '(9) If no well shall be drilled upon said premises within five years from this date, second party agrees to reconvey, and thereupon this instrument shall be null and void.'

"The purpose and effect of these clauses was plainly *(1)* to give the lessee two years within which to drill a well (not three wells, but one) upon the leased premises—not each tract, but the entire premises; *(2)* to enlarge that time, but not beyond five years, on condition that the lessee should pay an annual rental of $78 from the expiration of the second year until the well should be drilled; and *(3)* to entitle the lessor to a reconveyance of the premises if no well—none at all—should be drilled thereon within five years. Thus the measure of diligence which the lessee was required to exercise in prosecuting the work of exploration and development during the first five years was expressly and definitely prescribed, and was not left to any implication which otherwise might arise from the nature of the lease or from the other stipulations therein. It is appropriate to here refer to what was well said by the Supreme Court of Kansas, in disposing of a somewhat similar question, in the case of *Rose* v. *Lanyon Zinc Co.*, 68 Kan. 126, 74 Pac. 625:

> 'If plaintiffs should desire to contract for an immediate exploration, they must have that right; and if they should desire to give an oil or gas company five years in which to sink a well, upon a consideration satisfactory to themselves, and as the result of negotiations free from imposition and fraud, they must have that right. But, having deliberately made a contract of the latter description, they have no right to call upon a court to declare that it is of the other kind, merely because generally it might seem to be better for farmers not to incumber their lands with mineral leases, giving a long time for exploration, or because generally such leases do contemplate that forfeiture shall follow a failure to explore at once."

To the same effect see:

Texas Co. v. *Waggoner*, 239 S. W. (Tex. Civ. App.) 354;

Fisher v. *Crescent Oil Co.*, 178 S. W. (Tex. Civ App.) 905;

McCallister, et al., v. *Texas Co.*, 223 S. W. (Tex Civ. App.) 859;

Texas Co. v. *Curry*, 229 S. W. (Tex. Civ. App.) 643

Duke v. *Stewart*, 230 S. W. (Tex. Civ. App.) 485.

The *Brewster* case was decided in 1905, approximatel eleven years before the execution of the lease involved i the case at bar. Since that time it has been repeatedly cite and followed in Kansas and elsewhere. Probably no othe decision involving oil and gas law has been cited so frequent ly. Even Judge McDermott in his dissenting opinion herei is forced to admit that it "is undoubtedly the leading cas on the subject of implied covenants diligently to explor and develop." Strangely enough, considering his conclu sion herein, Judge McDermott also said: "As I read th decisions of the Kansas court, they adhere to the sam general test as announced in *Brewster* v. *Lanyon Zinc Co supra*, and followed by our court in *Denker* v. *Mid-Continen Petroleum Corporation*, 56 F. (2d) 725."

Likewise, the petitioners in their brief state that "th decisions of the Kansas court adhere to the same genera test as announced in *Brewster* v. *Lanyon Zinc Co.*, (C .C. A 8) 140 Fed. 801."

At least three of the Kansas cases upon which the peti tioners rely, to-wit: *Howerton* v. *Gas Co.*, 81 Kan. 553, 10 Pac. 47; *Alford* v. *Dennis*, 102 Kan. 403, 170 Pac. 1005 and *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033, cited an follow the *Brewster* case.

In *Webb* v. *Croft*, *supra*, one of the two cases which th

trial court cites as supporting its conclusion herein, and which we insist is opposed thereto, the Court said:

> "Defendants contend that as they had kept the lease alive by drilling one well during the lease period and had paid the accrued rentals and royalties, the court was not warranted in requiring further development, and that it therefore had read into the contract conditions not stipulated by the parties and had placed burdens on the defendants not contemplated by the contract. Leases of this kind contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development, nor yet the limiting of development to an extent merely to prevent a declaration of forfeiture. Although not expressly mentioned in the lease, there is an implied covenant or condition that there shall be reasonable development and such operation as will protect the interests of both lessor and the lessee. *Howerton* v. *Gas Co.*, 106 P. 47, 81 Kan. 553, 34 L. R. A. (n.s.) 34; *Id.*, 106 P. 813, 82 Kan. 367, 34 L. R. A. (n.s.) 46; *Alford* v. *Dennis*, 170 Pac. 1005, 102 Kan. 403; *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, 57 Oh. St. 118. The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land by *drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was a sufficient production to warrant the continuance of exploration and drilling.*"

The authorities announce two tests of compliance with the implied covenants of an oil and gas lease. The weaker of the two tests is referred to as the "good faith" standard and is applied by many of the federal courts and the courts of Pennsylvania, West Virginia, Kentucky and possibly oth-

er courts. According to this standard, all that is required of the lessee is that he act "in good faith on his business judgment", the courts having no power "to impose a different judgment on him, however erroneous it may deem his to be", and before the lease will be cancelled it is practically necessary to show that the lessee is acting "fraudulently with intent to obtain a dishonest advantage over the other party to the contract". The other and stronger test is referred to as the "ordinarily prudent operator" standard. This latter test is the one announced by the *Brewster* case and is the practically universal rule.

Mr. Merrill, in his Covenants Implied in Oil and Gas Leases, page 192, in referring to the ordinarily prudent operator standard, says:

> "What the conduct of this ordinarily prudent operator would be must depend upon many conditions. The lessee is certainly not required to engage in a losing venture merely on the chance of obtaining an increase in royalty for his lessor. So he is not required to engage in further development where he has already made heavy expenditures and it appears that additional wells would not be profitable. The abandonment of unprofitable wells is not a violation of the lessee's obligation to operate the premises, and he is not required to drill an offset well if it appears that it will not be sufficiently productive to repay the cost of drilling and operation."

In the case of *Goodwin* v. *Standard Oil Co. of Louisiana*, 290 Fed. 92, the Circuit Court of Appeals for the Eighth Circuit held:

> "In an action for the cancellation of oil and gas lease and damages for breach of implied covenant to

drill protection wells, the burden is on the plaintiff to prove the want of due diligence on the part of the lessees in drilling such offset well."

In said case the Court also held:

"Though a lessee, not guilty of fraud or bad faith, may be liable for failure to exercise reasonable diligence in drilling protection wells, and though the lease contains no express requirement, yet no breach of an implied covenant can occur except where the absence of such diligence on the part of the lessee is both certain and substantial, in view of the actual circumstances at the time as distinguished from mere expectations on the part of lessor and conjecture on the part of mining enthusiasts, the expense of exploration and development, and the fact that lessee must bear the loss of unsuccessful operation, entitle him to proceed with due regard for his own interests, as well as those of the lessor.

"Evidence that lessees began the drilling of the leased property within two months after the completion of the first well drilled on land adjoining the lease, and that within two months thereafter the defendants commenced the drilling of other offset wells, and that when completed the wells produced gas, but no oil, *held*, with other evidence as to the production on adjoining land, and the expense of well drilling, and the entire lack of market for gas, not to show such absence of reasonable diligence on the part of lessee as to drilling protection wells as was both certain and substantial, such as would warrant cancellation of the lease."

In the case of *Orr* v. *Comar Oil Co.*, 46 F. (2d) (10 C. C. A.) 59, the Court held:

"Burden is upon lessor to show that lessee, under implied covenant, failed to exercise reasonable diligence in drilling offset wells."

In the case of *Smith* v. *M Hill, et al.*, 12 F. (2d) (8 C. C. A.) 32, the Court held:

> "Lessor in oil and gas lease, alleging that lessee had failed to comply with conditions of lease in finding gas and oil in paying quantities within term, has burden of proof thereof."

The first paragraph of the syllabus to the case of *Denker* v. *Mid-Continent Petroleum Corporation*, 56 F. (2d) (10 C. C. A.) 725, reads as follows:

> "To comply with implied covenants to drill offset wells and diligently develop lease, lessee must do what operator of ordinary prudence, having regard to interests of both lessor and lessee, would do."

In the body of the opinion Judge PHILLIPS, speaking for the Court, said:

> "In order to comply with the implied covenants of a lease to drill offset wells and to diligently develop the lease, a lessee must do that which, under the circumstances, an operator of ordinary prudence, having regard to the interests of both lessor and lessee, would do. *Brewster* v. *Lanyon Zinc Co.*, (C. C. A. 8) 140 F. 810; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 P. 1069, 1072; *Goodwin* v. *Standard Oil Co.*, (C. C. A. 8) 290 Fed. 92; *Humphreys Oil Co.* v. *Tatum*, (C. C. A. 5) 26 F. (2d) 892; *Orr* v. *Comar Oil Co.*, (C. C. A. 10) 46 F. (2d) 59, 63; 40 C. J., p. 1067, Sec. 684."

The case of *Cosden Oil Company* v. *Scarborough*, 55 F. (2d) (5 C. C. A.) 634, was an action to cancel an oil and gas mining lease insofar as the same covered 400 acres. The lease involved covered 10,254 acres and was assigned by the original lessee to Cosden Oil Company insofar as it covered the 400 acres involved therein. Twelve wells had

been drilled on the 10,254 acres but no wells had been drilled upon the 400-acre tract. The Court, under these circumstances, held:

> "Implied covenant of oil and gas lease, arising after initial production of oil is obtained, imposes no absolute duty of development, but one measured solely by standard of diligence.
>
> "Test in determining whether implied covenant to develop oil and gas lease has been performed, is whether ordinarily prudent person would, under same or similar circumstances, cause drilling to be done."

In the opinion of the Court Judge HUTCHESON said:

> "Plaintiff pleaded, its testimony established, and the court found, that there was no way to tell in that territory whether oil and gas could be profitably produced without drilling for it. * * * Plaintiff offered no testimony of any person that a reasonably prudent operator, having in mind the interests of both lessor and lessee, would in the exercise of due diligence under the conditions prevailing, be justified in expending the sums necessary to drill a well on the property, nor did he offer any proof either by way of opinion evidence, or by way of evidence of persons who were willing, if given the chance, to so develop, that it would, under prevailing conditions, be a prudent thing to do. Defendant in addition to offering the testimony as to the actual results of operations in the territory, offered many witnesses, all practical oil men, who testified that, under conditions prevailing prior to and at the time of the suit, it could not be reasonably expected that anything but loss would come from drilling on its holdings. This proof established that it would be not a prudent, but a very imprudent operation to drill a well at this time, not so much because oil might not be found, as because if found, with the prevailing price and the small quantity of oil, it would not repay the

cost of development. Defendant offered proof, however, that it had not abandoned the lease; that it did intend to develop it when conditions became better, or if other operations in the territory furnished better ground for believing that a well could be profitably drilled. In short, their proof established that they had neither abandoned the property nor ceased operations upon it; that they were not operating on it now because it was not prudent to do so, but that as soon as prudent operation justified development, they would develop it.

"In Summers on Oil & Gas, pp. 434, 435, it is said: 'If the alleged breach of duty is upon the theory that the lessee has not drilled sufficient wells to secure all the oil and gas under the demised lands, then the lessor must prove that the drilling of additional wells is necessary, and that such wells may be reasonably expected, under all the circumstances, to be profitable to the lessee over and above all cost of drilling, operating and marketing the production.'

"This states the rule obtaining in Texas and generally elsewhere. *Texas Pacific Coal & Oil Co.* v. *Barker,* 117 Tex. 418, 6 S. W. (2d) 1031, 60 A. L. R. 936; *State Line Oil & Gas Co.* v. *Thomas,* (Tex. Civ. App.) 35 S. W. (2d) 746; *Brewster* v. *Lanyon Zinc Co.,* (C. C. A.) 140 F. 801; *Watchorn* v. *Roxana Petroleum Corp.,* (C. C. A.) 5 F. (2d) 636; *Texas Pac. Coal & Oil Co.* v. *Stuard,* (Tex. Civ. App.) 7 S. W. (2d) 878.

"The implied covenant springing after initial production obtained imposes no absolute duty of development, but one measured solely by the standard of diligence. The final test in every instance, to be applied by the court or jury trying the case, is whether an ordinary prudent person, having his covenant to develop and the interests of both lessor and lessee in mind, would, under the same or similar circumstances, cause drilling to be done. This test rejects the view erroneously advanced in some earlier Texas decisions (*Masterson* v. *Amarillo Oil Co.,* (Tex. Civ. App.) 253

S. W. 908; *Texas & Pacific Coal & Oil Co.* v. *Stuard,* (Tex. Civ. App.) 269 S. W. 482) that the lessee, if he acts in good faith, may be permitted to determine the extent of the diligence, with which development shall proceed, in favor of the view that it is for the court or jury trying the case to determine whether, under all the circumstances, including the cost of drilling and the probable profit therefrom, an ordinarily prudent person would have prosecuted development. *Texas & Pacific Coal & Oil Co.* v. *Barker, supra.* The fact that appellant has spent no money in development upon the 400 acres does not differentiate this case in principle from *Leonard* v. *Prater, supra,* where the lessee had. Large sums of money, much greater than were spent in *Leonard* v. *Prater* contributed in part by appellant and others, were spent by the lessee in drilling the first well. Other operators, at great cost and loss, have expended money in developing that territory, which has so far proven unprofitable. Appellant had the right, as an ordinarily prudent person, to take those developments and their result into consideration in determining what it should do. It was the duty of the court below, it is our duty, in applying the test, to consider them."

The identical question under consideration was before the Supreme Court of Oklahoma in the quite recent case of *Franklin, et al.,* v. *Wigton,* 132 Okl. 236, 270 Pac. 1, the second paragraph of the syllabus of which reads as follows:

> "A lessee of an oil and gas lease, upon an implied covenant to prevent drainage, is not required to drill an offset well unless oil or gas is found on adjacent lands, near the boundary line of lessors' land *in sufficient quantities to pay a reasonable profit on the whole sum required to be expended,* including the cost of drilling, equipping and operating the well."

In the course of the opinion in said case the Court said:

"As to the second cause of action, we are of the opinion that the demurrer to plaintiffs' evidence was properly sustained. The evidence discloses that a well was drilled 150 feet east of the line of plaintiffs' premises in which there was some showing of gas. There is no evidence as to the quantity produced; no evidence that gas was ever marketed from the well; no evidence whatsoever from which it could be inferred that the well was a paying well. In these circumstances, defendant was not required to offset this well. Before plaintiffs would be entitled to an offset it was incumbent upon them to show by some evidence that it was proable that a paying well could have been drilled. *Eastern Oklahoma Oil Co.* v. *Beatty, et al.*, 71 Okl. 275, 177 Pac. 105; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069.

"In the case of *Pelham Petroleum Co.* v. *North, supra*, this Court says:

> 'A stipulation in an oil and gas lease whereby the lessee obligates itself "to protect the side lines in case oil is found in paying quantities" imposes upon the lessee the same obligation to protect the lessor's land from actual or threatened drainage that the courts universally hold to be upon it in the absence of express stipulation to that effect. The provision means that the lessee is required to drill an offset well in case oil is found on adjacent lands near the boundary line of lessor's land in sufficient quantities to pay a reasonable profit on the whole sum required to be expended, including the cost of drilling, equipping and operating the well.'

"Under these authorities, the court was correct in sustaining the demurrer."

In the still more recent case of *Robinson, et al.*, v. *Miracle, et al.*, 146 Okl. 31, 293 Pac. 211, the Supreme Court of Oklahoma said:

"It is well settled in this jurisdiction that there is an implied covenant, in oil and gas mining lease contracts which contain no specific provision providing for the number of wells to be drilled in case paying production is discovered, to operate diligently and develop oil and gas lease premises after paying production has been discovered for the mutual benefit or profit for both lessor and lessee, and neither is, in the absence of a stipulation to that effect, the arbiter of the extent to which or the diligence with which the operation shall proceed, but both are bound by the standard of what in the circumstances would be reasonably expected of an operator of ordinary prudence having regard to the interest of both. Equity abhors forfeitures, but will, where justice requires, cancel a lease contract by reason of the lessee's failure diligently to produce and develop the premises. *Brewster* v. *Lanyon Zinc Co.*, (8th C. C.) 140 Fed. 801; *Indiana Oil, Gas & Development Co.* v. *McCrory*, 42 Okl. 136, 140 Pac. 610; *New State Oil & Gas Co.* v. *Dunn*, 75 Okl. 141, 182 Pac. 514; *Strange* v. *Hicks*, 78 Okl. 1, 188 Pac. 347; *Pelham Petroleum Co.* v. *North*, 78 Okl. 39, 188 Pac. 1069; *Gypsy Oil Co.* v. *Cover*, 78 Okl. 158, 189 Pac. 540; *Wapa Oil & Development Co.* v. *McBride*, 84 Okl. 184, 201 Pac. 984; *Papoose Oil Co.* v. *Rainey*, 89 Okl. 110, 213 Pac. 882; *Mistletoe Oil & Gas Co.* v. *Revelle*, 117 Okl. 144, 245 Pac. 620; *Scott* v. *Price*, 123 Okl. 172, 247 Pac. 103; *Fox Petroleum Co.* v. *Booker*, 123 Okl. 276, 253 Pac. 33; Merrill, Covenants Implied in Oil and Gas Leases, sections 3, 43, 44, 48, 53, 117. This is as well true where gas production is had as when the paying production discovered is oil. *Blackwell Oil & Gas Co.* v. *Whiteside*, 71 Okl. 41, 174 Pac. 573; *Donaldson* v. *Josey Oil Co.*, 106 Okl. 11, 232 Pac. 821; *Carder* v. *Blackwell Oil & Gas Co.*, 83 Okl. 243, 201 Pac. 252. Each time an effort is made to cancel a lease for breach of the implied covenant to diligently develop and produce oil and gas lease premises is controlled by its own facts. Neither lessor nor lessee may presume arbitrarily to determine

of what diligence should consist, what a reasonable operator should do under the circumstances, having in mind that the purpose of the contract is the mutual benefit of the landowner and the operator, that the landowner might receive within a reasonable time the benefits, the profits, from the minerals which may be extracted from under his premises, and that the operator might make a profit on his operations of the premises. *The lessee is not required to drill additional wells where the probability of his making a profit on the further operations is small.* However, the lessee will not be permitted to delay unduly further drilling operations after production is obtained *because of his caprice and arbitrary determination* that he could make more money by deferring his future drilling operations. As was said in *Brewster* v. *Lanyon Zinc Co., supra:*

> 'Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior exploration and development, the local market or demand therefor or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. *Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.'*

"In the instant case there are no producing wells draining that portion of the lease which the court cancelled. However, the court found under the evidence that the lessees, in view of all the circumstances obtaining, had failed to diligently develop and operate the full lease, and had for all practical purposes abandoned the lease except the 40 acres on which the pro-

ducing well is located. We cannot say that this determination is against the clear weight of the evidence so the judgment thereon will be affirmed."

In the case of *Empire Gas & Fuel Co.* v. *Haggard*, 152 Okl. 35, 3 P. (2d) 675, which is the most recent Oklahoma case which we have found on the subject, the Supreme Court of Oklahoma said:

> "Speaking on the question of the duty of the lessee to continue operations, the Circuit Court of Appeals, in the case of *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, said:
>
> > *'No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them.'*
>
> "See, also: *Goodwin* v. *Standard Oil Co.*, 290 Fed. 92 (1923); *Indiana Oil Co.* v. *McCrory*, 140 Pac. 610; 42 Okl. 136; *United Central Oil Corp.* v. *Helm*, 11 Fed. (2d) 760."

In the case of *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okl. 158, 189 Pac. 540, there was involved an oil and gas mining lease covering 160 acres of land, 120 acres thereof being contiguous, and the other 40-acre tract being located one-half mile therefrom. The lease was for a term of five years, and as long thereafter as oil or gas was produced therefrom. The lessee assigned the lease as to the aforesaid 40-acre tract, and the assignee within the primary term of the lease brought in a producing well thereon. No well whatsoever was drilled on the 160-acre tract, but, notwithstanding this fact, it was held that the one well on the 40-acre tract kept the lease alive during and beyond the primary term thereof as to the whole lease, or, in other words, both as to the 40-

acre tract and the 120-acre tract. In the course of the opinion in said case the Court said:

"It is admitted that one producing well was put down by Davis and the Producers' Oil Company within one year from the date of the lease; also that no well was drilled on the 120-acre tract or rentals paid. This court held in the case of *Roach* v. *Junction Oil & Gas Co.*, 179 Pac. 935, that after gas was found upon the leased premises within five years from date thereof in paying quantities, the lessee thereby became vested with a limited estate in the leased premises for further operations in accordance with the terms of the lease—citing *Brennan* v. *Hunter*, 172 Pac. 49, citing numerous cases. * * * We are aware that this court has held that oil and gas leases will be so construed as to promote development and prevent delayed unproductiveness. *Parafine Oil Co.* v. *Cruce*, 162 Pac. 816; *New State Oil & Gas Co.* v. *Dunn*, 75 Okl. 141, 182 Pac. 514; and *Curtis* v. *Harris*, 184 Pac. 574, not yet officially reported. This court has also held that a court of equity will, where necessary, decree forfeiture of oil and gas leases on account of a breach of an implied covenant to diligently operate and develop the property when such forfeiture will perpetuate justice (*Ind. Oil & Gas Co.* v. *McCrory*, 42 Okl. 136, 140 Pac. 610; *Blackwell Oil & Gas Co.* v. *Whitesides*, 174 Pac. 573), and such has been the holding of the federal courts in numerous cases, the leading case being that of *Brewster* v. *Lanyon Zinc Co.*, 140 Pac. 801, 72 C. C. A. 213. This lease was for a period of five years from date and as long thereafter as oil and gas or either of them is produced from the premises by the lessees, its successors or assigns.

"This lessee agreed to complete a well on the premises within one year or pay at the rate of $160 in advance for each additional twelve months completion is delayed until a well is completed. The lease contains no covenant as to the number of wells to be drilled on

the premises. The lease contains no express stipulation that anything should be done in the way of drilling for and producing oil and gas after the first five years. We think the rule announced by this court in the cases cited *supra* is the rule to be applied here, which is thus stated in the *Brewster* case:

> 'There could not well have been an express stipulation as to the number of wells to be drilled, as to when the wells, other than the first, should be drilled, or as to the rate at which the production therefrom should proceed, because these matters would depend in large measure upon future conditions, which could not be anticipated with certainty, such as the extent to which oil and gas, one or both, could be produced from the premises, as indicated by the first well and any others in the vicinity, the existence of a local market or demand therefor or the means of transporting them to a market, and the presence of wells on adjacent lands capable of diminishing or exhausting the supply in the natural reservoir. The subject was therefore rationally left to the implication, necessarily arising in the absence of express stipulation, that the further prosecution of the work should be along such lines as would be reasonably calculated to effectuate the confrolling intention of the parties as manifested in the lease, which was to make the extraction of oil and gas from the premises of mutual advantage and profit. Even in respect of the first well, if oil or gas was found in paying quantity, there was no express engagments to operate it; but that it was intended to be operated was plainly implied in the engagement to pay royalties to be gauged according to the production of oil and the use of gas. Whatever is necessary to the accomplishment of that which is expressly contracted to be done is part and parcel of the contract, though not specified. * * *'

"With these rules in mind, let us examine the circumstances surrounding the parties as disclosed by the record for the purpose of supplying the rules to the facts. The finding of the trial court was as follows:

> 'The court finds that the plaintiffs are the owners of the land in controversy and went in possession of the premises at the time of taking said deed, Exhibit No. 1, and have retained possession of the land since that date.'

"The facts thus found would not be sufficient to authorize the court to cancel the lease for a breach of an implied covenant to diligently operate and develop the premises. Concerning that matter, the learned judge in the opinion in the *Brewster* case, *supra,* said:

> 'There can, therefore, be a breach of the covenant for the exercise of reasonable diligence, though the lessee be not guilty of fraud or bad faith. But, while this is so, no breach can occur save where the absence of such diligence is both certain and substantial in view of the actual circumstances at the time, as distinguished from mere expectations on the part of the lessor and conjecture on the part of mining enthusiasts. The large expense incident to the work of exploration and development, and the fact that lessee must bear the loss, if the operations are not successful, require that he proceed with due regard to his own interests, as well as those of the lessor. *No obligation rests on him to carry the operations beyond the point where they will be profitable to him, even if some benefit to the lessor will result from them.* It is only to the end that the oil and gas shall be extracted with benefit or profit to both that reasonable diligence is required. Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, such as the quantity of oil and gas capable of being produced from the premises, as indicated by prior

> exploration and development, the local market or demand therefor, or the means of transporting them to market, the extent and results of the operations, if any, on adjacent lands, the character of the natural reservoir—whether such as to permit the drainage of a large area by each well—and the usages of the business. Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required'."

There is almost no end to the cases which could be cited to the same effect as the foregoing.

Inasmuch as it is admitted that the two wells drilled by the respondent upon the premises involved herein were drilled during the primary term of its lease, that oil was discovered in paying quantities in each of said wells, that at all times subsequent to the completion of said wells they had produced oil in paying quantities and were still so producing it necessarily follows that the respondent's lease was in full force and effect as to each and every part of the leased premises, unless it had abandoned some portion of the leased premises, or unless it had failed to drill some "offset" well, which it was required to drill, or unless a reasonably prudent operator, under the existing circumstances, would have drilled an additional well or wells upon the leased premises, and the burden was upon the petitioners to both plead and prove that some one of said conditions had transpired.

There is no allegation in the petitioners' bill that the respondent had ever abandoned any portion of the premises involved herein. Furthermore, there was no proof of any such abandonment and the trial court did not find that

there was any abandonment. Consequently the sole question involved was whether the respondent had breached the implied covenants of its lease with reference to further development of the leased premises.

It is extremely doubtful whether the allegations of the petitioners' bill are sufficient to constitute a charge that the respondent had violated either an express or an implied covenant of its lease. The most that can be said of said bill is that the petitioners allege that they are "informed and verily" believe that there "is grave danger" of drainage of oil from under the premises involved by reason of wells on adjoining premises and that the development upon lands adjacent to the lands covered by the respondent's lease "has made it practically certain that oil could have been discovered in paying quantities by the drilling" of additional wells on said lease. Perhaps these allegations are tantamount to an allegation that under the existing circumstances an operator of ordinary prudence, having regard to the interests of both lessor, and lessee, would have drilled an additional well or wells upon the premises involved herein, but we doubt it.

In any event the petitioners offered no evidence whatsoever that there were any "offset" wells upon any premises adjacent to the lands involved herein, save and except the two wells which it is admitted the respondent had offset, or that there were any wells upon adjoining premises which were draining or were likely to drain oil from under the premises involved herein, or that the drilling of additional wells upon said premises would have been profitable. On the contrary, counsel for the petitioners, in his opening statement to the court, stated that "it is impossible to tell whether a

development of this lease would have yielded profits." It is, therefore, clear that the petitioners wholly failed to discharge the burden of proof imposed upon them.

On the other hand, and although it was probably not required so to do, the respondent established by uncontradicted evidence that it had not abandoned any part of the premises involved herein, that none of the wells on adjoining premises was an "offset" to the lease involved herein, that it would in all probability have been unprofitable for it to have drilled any additional well or wells upon said lease, that no reasonably prudent operator, under the existing circumstances, would have drilled any such additional well or wells, and that the respondent was ready, able and willing to drill additional wells on said lease if future developments justified it.

The findings of the trial court are wholly insufficient to support its judgment and as a matter of fact are contrary thereto. In said findings said court found that the two wells upon the premises involved herein were drilled during the primary term of respondent's lease, that oil was discovered in each of said wells in paying quantities, that at all times subsequent to the completion of said two wells they had produced oil in paying quantities and were still so producing. Said court also found that while the respondent had introduced "the evidence of expert witnesses who testified rather positively that in their judgment none of the production adjacent to the land described in this lease is draining any oil from petitioners' land, "this evidence as to drainage is not wholly convincing to the court." Said court further found that neither the petitioners nor the respondent had introduced any positive evidence as to the contention of the

petitioners that there was a well defined trend of oil producing sand and lime under petitioners' land and that "on this point the court is unable to determine the facts" and "that nothing but exploration and positive tests by drilling upon said land can settle the controversy as to whether oil and gas in paying quantities can be found thereon." Nowhere in its said findings did said court find, as it was necessary for it to find, in order to justify the cancellation of the lease involved herein, that if additional wells had been drilled on the leased premises oil would have been discovered in paying quantities or that a reasonably prudent operator would have drilled any adidtional well or wells upon said premises, or that the respondents had failed to comply with any of the express or implied covenants or conditions of its lease. We, therefore, insist that the reversal of the decrees of the trial court was inevitable.

None of the Kansas cases, whether decided prior or subsequent to the execution of the lease involved herein, except certain *obiter dictum* in *McCarney v. Freel*, 121 Kan. 189, 246 Pac. 500, conflicts with respondent's contention, but, if anything, they support the same.

In support of their contention that the Kansas cases are contrary to respondent's contention and the holding of the Circuit Court of Appeals herein the petitioners cite: *Mills* v. *Hartz*, 77 Kan. 218, 94 Pac. 142; *Howerton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 106 Pac. 47; *Id.*, 82 Kan. 367, 108 Pac. 813; *Culbertson* v. *Cement Co.*, 87 Kan. 529, 125 Pac. 81; and *Day* v. *Kansas City Pipe Line Co.*, 87 Kan. 617, 125 Pac. 43, all decided prior to the execution and delivery of the lease involved herein; and *Alford* v. *Dennis*,

102 Kan 403, 170 Pac. 1005; *Webb* v. *Croft*, 120 Kan. 654, 244 Pac. 1033; and *McCarney* v. *Freel*, 121 Kan. 189, 246 Pac. 500, decided subsequent to the execution and delivery of said lease. None of said cases, however, with the exception of certain *dictum* in *McCarney* v. *Freel, supra,* supports petitioners' contention, but on the contrary all of said cases, with the exception of the aforesaid *dictum,* support the contention of the respondent and the holding of the Circuit Court of Appeals herein.

The Circuit Court of Appeals considered and reviewed the Kansas decisions, and after announcing the general rule with reference to the implied obligation of an oil and gas lessee to further develop, said:

> "This is the rule announced by the great weight of authority. *It has been approved by the Kansas decisions.* See *Webb* v. *Croft,* 120 Kan. 654, 244 Pac. 1033; *Howerton* v. *Kan. Nat. Gas Co.,* 81 Kan. 553, 106 Pac. 47; *Id.,* 82 Kan. 367, 108 Pac. 813; *Day* v. *Kansas City Pipe Line Co.,* 82 Kan. 861, 109 Pac. 186."

Mills v. *Hartz, supra,* was an action to cancel an oil and gas lease for a primary term of 20 years and as much longer as gas, coal and oil were found in paying quantities. Said lease contained no provision with reference to the commencement of a well on the leased premises. There was no development whatever upon said premises, and after a lapse of 7½ years the action was commenced to cancel said lease. There was no showing that it probably would not have been profitable to drill a well on said premises. The Court simply held in said case that where an oil and gas lease contains no provision with reference to the commencement of development there was an implied obligation to commence devel-

opment within a reasonable time after the execution of the lease and that the failure to commence development was a practical abandonment of the lease, There was no question in said case of the extent of the development required after oil or gas was discovered in paying quantities or of the right of the lessee to hold all of the leased premises after the discovery of oil and gas thereon where the circumstances indicated that oil or gas in paying quantities could not be produced from additional wells. It, therefore, follows that said case is not an authority one way or the other in the case at bar.

If the lessee in the foregoing case had drilled one or more wells on the leased premises within a reasonable time after the date of the execution of his lease, had discovered oil or gas in paying quantities therein, had continuously operated said well or wells, and suit had been brought to cancel the undeveloped portion of the lease for not having drilled an additional well or wells and it had been shown that it would probably not have been profitable to drill such additional well or wells, then said case would be in point with the case at bar. But no such situation—which is the situation involved in the case at bar—was involved in said case.

The gist of the Court's opinion in the foregoing case is to be found in this language: "Since the time for *commencing* the operation is not expressly stated, we must look to the terms of the lease and the subject of the contract to determine what was within the contemplation of the parties. We think the Court rightly held that, under such lease, it was the duty of the lessee to make a diligent search within a reasonable time." The lease in the case at bar,

unlike that in the foregoing case, expressly and specifically provides that the first well shall be commenced within one year, but that the commencement of said well might be deferred from year to year during the primary term of the lease by the payment of an annual rental of $1.00 per acre. And during the primary term of said lease the respondent or its predecessors in title drilled two wells upon the leased premises, discovered oil in paying quantities in each of said wells, and has continuously operated them and produced oil in paying quantities therefrom.

In the foregoing case the Court said: "When a lease provides how and when search for oil or gas shall be made, there is no room for implication. Likewise, if the parties provided for an option in the lessee to operate and pay a royalty on production, or to pay a stated rental if no development is made, the lessee may elect to delay and pay the stipulated price of such delay."

The original opinion in *Howerton* v. *Kansas Natural Gas Company, supra,* is reported in 81 Kan. 553, 106 Pac. 47, and discloses that the lease involved was executed on the 20th day of November, 1902, and was for a period of 10 years and as long thereafter as oil or gas was produced in paying quantities. Within one year after the execution of said lease a gas well was drilled on the leased premises capable of producing gas in commercial quantities sufficient to justify the expense of marketing the same. Nevertheless no sale of gas was made from said well and gas was not used therefrom in any way except that the lessee used some for fuel to furnish power for the drilling of two wells on adjacent premises leased from other owners. There was no further development or operation on said premises, and

on the 17th day of November, 1907, the lessor declared a forfeiture of the lease. Said lease provided that a well should be drilled thereon within one year and contained no provision for the payment of rentals for delay or failure to prosecute the work of development. There was no showing that gas could not be produced in paying quantities from additional wells, but the inference reasonably to be drawn from the opinion is that if additional wells had been drilled gas could have been produced therefrom in paying quantities. The lessee offered no excuse or justification whatever for its failure to market the gas from the well drilled or for its failure to further develop the premises. The Court in said case simply held that since the lessee was obligated to drill a well, it was further obligated to market the product of said well for the mutual benefit of the parties and that its failure to do so justified a forfeiture of the lease. While the opinion of the court states that the lessee was obligated to reasonably develop the premises, the court did not attempt to define "reasonable development", but it is clear that the court was of the impression that if additional wells had been drilled they would have produced in paying quantities. In the case at bar, as heretofore pointed out, the respondent was producing oil from the premises involved in paying quantities, and the uncontradicted evidence disclosed that oil could not have been found in paying quantities in any additional well or wells. Therefore, the aforesaid case is not an authority for the contention of petitioners.

The foregoing case was decided as though no well had been drilled by the lessee, the Court saying: "It is difficult to distinguish in principle between a case like that where a

default consists in failure to explore at all and a case like the present one, where a well has been drilled and the gas found, but no effort has been made to utilize or market it." If the gas well involved in the foregoing case had been operating—that is, if the gas had been continuously marketed therefrom, and the evidence had all been to the effect that it would probably not have paid to have drilled an additional well or wells and a suit had been brought to cancel the undeveloped portion of the lease, the case would be in point with the case at bar. However, no such state of facts was involved in said case.

The original opinion in the *Howerton* case, *supra*, was overruled on rehearing and the case reversed and remanded for further proceedings, as appears from the opinion in 82 Kan. 367, 107 Pac. 813, and we earnestly insist that the opinion on rehearing in said case is an authority for the contention of the respondent. On said rehearing, the Court held that the evidence did not disclose a right to have defendant's lease cancelled, but that the plaintiff was entitled to damages for the defendant's default. The Court said:

> "The default consisted in the failure to properly develop the leased territory by drilling and operating a reasonable number of wells necessary for that purpose, and the failure to market gas and make the payments, stipulated for the well completed. *No reason is shown why witnesses of experience acquainted with the gas field, may not testify with reasonable accuracy as to the number of wells which should have been drilled on the leased land both for protection from drainage by neighboring leaseholds and to obtain the gas underneath the land.* No insurmountable obstacle to such proof is perceived by the court, and, in the absence of evidence that it cannot be produced, it is concluded that the plaintiff

is not entitled to a remedy by forfeiture or cancellation of the lease. * * *

"It should be observed that this is not a case where royalties payable in a share of the product are provided for, but is an agreement to pay $50 per annum for each gas well. *The measure of damages therefore is the sum the plaintiff has lost or may lose by the failure of the defendant to complete the number of producing wells reasonably necessary to develop the resources of the leased land and to protect its lines.* * * *".

To the same effect was the specially concurring opinion of Justice PORTER, in which he said:

"I think the court should declare as a matter of law, from its knowledge of conditions in the oil and gas territory, *that witnesses of experience can testify with reasonable accuracy what number of wells would be required properly to develop the land embraced in the lease including such wells as would reasonably be necessary to protect the land from drainage from other wells*, and that since judicial knowledge takes the place of proof we should hold that the action to forfeit or cancel the lease cannot be maintained because it appears that the plaintiff has an adequate remedy in an action for damages."

Culbertson v. *Iola Portland Cement Co., supra*, was an action for an accounting from the defendant for gas obtained and used by it from the plaintiff's land through wells on his land and through wells drilled by defendant on adjoining land. It was alleged that there was a general pool of gas under plaintiff's land and that the defendant had drilled wells on adjoining premises and through them extracted gas from plaintiff's land. The evidence disclosed, and the referee to whom the case was referred found, that a large quantity of gas had been taken from said land, and the Court

held that plaintiff was entitled to an accounting therefor, whether it was obtained from wells drilled on his land or from those drilled on adjacent premises. In its opinion the Court said:

> "Since the number of wells to be drilled on the land was not specified, there was an implied obligation on appellants to fully develop the land and *put down as many wells as were necessary to secure to appellee his proportionate share of the pool of gas.*"

It clearly appears that the Court was not of the opinion that the defendant was obligated in all events to drill additional wells on the plaintiff's land, but was required only to drill such number of wells as were necessary to secure to the plaintiff his proportionate share of the pool of gas which the evidence disclosed underlaid his land and was being drained therefrom through wells on adjoining lands.

If it had been specifically shown by the defendant in the foregoing case, as was shown by the respondent in the case at bar, that it would probably not have paid to drill a well or wells upon the leased premises and that there had been and was no drainage through wells on adjoining premises, said case would be in point with the case at bar. But it appears that the very opposite was shown.

Day v. Kansas City Pipe Line Co., supra, was an action to cancel the undeveloped portion of a 600-acre lease by reason of the failure of the lessee to properly develop. Said lease required the lessee to drill 4 wells within 6 months and "*to continue drilling as long as paying wells were found or royalties were paid*". The original lessee drilled and completed 4 wells on 80 acres of said premises within the first 6 months after said lease was executed. No further de-

velopment was had for approximately 4 years, when the plaintiff filed his original petition. Subsequent to the filing of said petition, the lessee drilled 4 additional wells on another 80 acres of said lease, which produced oil in paying quantities, leaving the remainder of the 600 acres undeveloped. The trial court found that the lessee had not exercised reasonable diligence in developing the premises in accordance with the aforesaid provision of the lease and cancelled the lease as to all of the leased premises except the aforesaid 160 acres. There was no evidence that if additional wells had been drilled on the remainder of said premises oil or gas could not have been discovered therein in paying quantities, but the court simply held that *under the aforesaid clause of the lease requiring the lessee to continue drilling as long as paying wells were found or royalties were paid the lessee was expressly obligated to drill additional wells.* In its opinion the Court does not attempt to define "reasonable diligence" in any case, but says that "*what is due diligence is a question of fact* which has been decided adversely to the contention of appellant". Said case is, therefore, no authority that drilling and producing oil in paying quantities from the two wells involved in the case at bar was not due diligence, in view of the uncontradicted evidence that oil or gas could not have been produced in paying quantities from any additional well or wells on the premises involved. The statement by the court that if paying wells could not be found on the land, or any part of it, there was no reason why appellant's title should be longer clouded with a barren encumbrance or any reason why appellant should resist cancellation, was *obiter dictum,* and certainly not binding upon the federal court.

In the foregoing case the Court specifically said "it was not enough that 4 wells should be drilled within 6 months or any limited number on a part of the tract, but it was specifically required that drilling should continue with reasonable diligence *so long as paying wells could be found. The appellant was, of course, not required to develop land that had been tested and found to be unprofitable for operation* * * *."

It will thus be seen that none of the foregoing cases decided prior to the execution of the lease involved in the case at bar is contrary to respondent's contention. And *Brewster* v. *Lanyon Zinc Co., supra,* decided approximately 11 years before the execution of the lease involved herein, squarely supports such contention. Let us, therefore, proceed to analyze the cases decided subsequent to the execution of said lease.

The first case, *Alford* v. *Dennis, supra,* was an action to cancel an oil and gas lease in so far as it covered 220 acres of land belonging to the plaintiff. The original lease covered a tract containing some 936 acres, consisting of one tract of 716 acres and another tract some 2 miles distant therefrom, being the 220-acre tract in question. Subsequent to the execution of the lease the ownership of the two tracts was separated. Said lease was for a period of 10 years and as much longer as gas or oil was produced in paying quantities, and provided that the lessee should begin operations thereunder within 6 months from the delivery of the lease, and complete 3 wells on said premises, and that no other or additional expense should be incurred under said lease by the lessee. Twenty-five wells were drilled on the larger tract and the lessee paid royalties to the then

owners thereof, but never at any time during the 13 years between the execution of the lease and the commencement of the action did any drilling on the smaller tract. The petition disclosed that there had been three separate and distinct oil booms in the vicinity and that the plaintiff had had several opportunities to lease the aforesaid 220-acre tract, and prayed for a cancellation of the lease insofar as it covered said 220 acres. The lessee's demurrer to said petition was sustained by the trial court, from which ruling the lessor appealed. The opinion of the court recites that it was improvident for the owner to grant a lease on two large tracts for a long term without any requirements of exploration and development, but that it was not the province of the court to end a contract merely because it was a bad bargain. The court further stated that the petition narrated a predicament capable of some legal or equitable redress, not necessarily the redress prayed for by the plaintiff, and held that the case should be reversed and remanded to the trial court with directions to permit the issues to be joined and the facts determined and to allow plaintiff damages if they could be definitely ascertained, and in the alternative that the lessee be required to proceed in good faith to develop the premises within a reasonable time. Said opinion does not disclose that it was improbable that oil or gas could be produced on said premises in paying quantities. On the contrary, it is obvious that the court, under the allegations of the plaintiff's petition, was of the opinion that if further development was made oil or gas in paying quantities could be discovered. This conclusion is inevitable in view of the fact that the case of *Harris* v. *Ohio Oil Co.*, 48 N. E. 502, relied on by the Court in support of its decision

that the premises should be developed, held that the development required is such as is "usually found in the same business of an ordinary prudent man," and all that is required of the lessee is to drill such wells as are necessary for the production of the oil contained in the premises and afford ordinary protection to the lines. We are certainly not justified in assuming that there was any showing in the case that oil or gas in paying quantities could not be discovered, or that the court intended to require the defendant to perform apparently useless acts. The court did say that unless the plaintiff's tract was to be developed some time there was no reason to include it in the lease and that if the defendant had no bona fide intention to develop said tract to cancel the lease would do him no injury, but, as heretofore pointed out, the court refused to cancel said lease and said statemen was *obiter dictum.* Said case is certainly no authority for the proposition that where there are producing wells on a lease and the evidence discloses that oil or gas probably would not be discovered in paying quantities on the remainder of the lease, the lessor is entitled to a cancellation as to the undeveloped portion of the lease.

The foregoing case seems to have been decided upon the theory that since the lease involved did not specify the time for the commencement of a well upon the 220-acre tract, which was not contiguous to the other 716 acres covered by said lease, the law implied an obligation to commence a well thereon within a reasonable time from the date of the lease.

If all the land covered by the lease in the foregoing case had been contiguous and producing wells had been

drilled thereon and continuously operated, and it had been shown that it would have probably been unprofitable to drill an additional well or wells, and a suit had been brought to cancel the undeveloped portion of the lease, the case would be in point with the case at bar. And in this connection it is to be noted that in said case the plaintiff did not seek to cancel the undeveloped portion of the 716-acre tract on which producing wells had been drilled.

Webb v. *Croft, supra,* was an action to cancel an oil and gas lease on several tracts of land, comprising 580 acres. The lease was for a term of 5 years and as long thereafter as oil or gas, or either of them, was produced therefrom. Said lease further provided that the lessee should complete a well within 12 months from the date of the lease or pay to the lessor $580.00 per year for each year drilling was delayed. There was no development until shortly prior to the expiration of the primary term of the lease, but a producing gas well was completed one day before the expiration of the lease. The trial court found that the lease had not been sufficiently developed and decreed that there should be further development and provided in said decree what further development should be made and the time within which it should be made. From said decree the defendant appealed. The only justification offered by the defendant for its failure to drill any other or additional wells on the premises was that there was no market for more gas in the vicinity than was already being produced. There was no showing that oil or gas could not have been discovered in paying quantities had additional wells been drilled. Relying on and citing with approval *Howerton* v. *Kansas Nat-*

ural Gas Company, supra, and *Alford* v. *Dennis, supra,* the Court said:

> "The lease is silent as to the number of wells that shall be drilled on the land, and in such a case there is an implication that there shall be reasonable development of the land *by drilling such number of wells as an ordinary prudent man would do under the circumstances, taking into consideration the results of the development and whether or not there was sufficient production to warrant the continuance of exploration and drilling.*"

Therefore, the foregoing case, rather than being an authority for the contention of the petitioners, is a direct authority for the contention of the respondent.

Clearly the Court ordered development under the justified assumption that oil or gas could be produced in paying quantities from additional wells.

In the foregoing case the Court said:

> "Two producing oil wells have been drilled by others on land in the vicinity of that in question, and there is some reason to infer that through exploration oil might be found on the land of plaintiff. *Gas has been found there, and yet defendants have failed for four years to drill another well near the producing one, and their excuse is that there is no market in that locality for more gas than is already being produced and no more than is necessary to supply the City of Moline.* * * *"

McCarney v. *Freel, supra,* is the only Kansas case cited by the petitioners which is in the least contrary to the contention of the respondent. That case was an action to cancel an oil and gas mining lease which covered a quarter section of land, which said lease was for a term of 10 years

and as much longer as oil or gas could be produced in paying quantities. Four months after the execution of the lease a well was drilled, which produced oil in paying quantities, and continued to so produce until the time of the trial of said case. Five years thereafter a dry hole was drilled on said premises, and no further effort was made to develop the resources of the land. The trial court cancelled said lease, and, in affirming the action of the trial court, the Supreme Court said that the "plaintiff's evidence warranted the inference that defendants have not reasonably developed her land." Upon that theory alone the plaintiff was entitled to a cancellation of the lease on the undeveloped portion of the leased premises. The Court, however, went on to say:

> "If the undeveloped portion of the land will not produce mineral in paying quantities, and the lessee would not be justified in drilling more wells, he may not continue to hold by virtue of a provision in the lease extending the term so long as oil or gas may be produced in paying quantities."

The opinion in said case covers less than a half page of the Pacific Reporter, and the Court does not cite a single case in support of its conclusion. Said case is contrary to the decision of the same Court in *Webb* v. *Croft, supra,* decided a few months prior to said case. We, therefore, earnestly insist that little or no weight should be attached to said case, and that since said case was decided long subsequent to the execution of the lease in the case at bar and is contrary to the former decisions of the same Court, the decision in said case is not binding upon the federal court as establishing a rule of property.

Summarizing, none of the foregoing cases, with the exception of the *dictum* in *McCarney* v. *Freel, supra,* is authority for the petitioners' contention that there is an implied covenant in an oil and gas mining lease to further develop the premises under lease where the evidence discloses that oil or gas is being produced therefrom in paying quantities and further discloses that oil or gas could not be produced in paying quantities in any additional well or wells on said premises, and that no reasonably prudent operator would drill an additional well. On the contrary, said cases clearly establish that under a lease such as is involved in the case at bar the lessee is obligated to drill only such wells as a reasonably prudent operator would, under the circumstances, drill. It, therefore, follows that the decision of the Circuit Court of Appeals herein is not contrary to the Kansas decisions.

It is very significant that in most of the foregoing Kansas cases the Court considered the developments upon lands in the vicinity of those involved, but we submit that, if, as is contended by petitioners, a producing oil and gas lease in Kansas may be cancelled as to the undeveloped portion thereof upon the sole ground of no additional drilling during a long lapse of time, then, the developments upon surrounding lands and the prospect of discovery of oil or gas in paying quantities in additional wells are wholly immaterial.

The Kansas cases require the plaintiff in an action to cancel an oil and gas lease for breach of an implied obligation to develop or further develop to show as a prerequisite to the right of cancellation that plaintiff's damages are not susceptible of measurement, and no such showing was made in the case at bar.

In the case of *Howerton* v. *Kansas Natural Gas Co.*, 81 Kan. 553, 108 Pac. 813, it was specifically held that in an action to cancel an oil and gas lease for failure to fully develop the leased premises the burden was upon the plaintiff to show that a remedy in damages was not an adequate remedy and in the absence of such showing a decree for cancellation would not be sustained. In the case at bar no such showing was made or even attempted.

The respondent has never abandoned the premises involved herein, or any part thereof.

We have heretofore called the court's attention to the fact that there is no allegation in the petitioners' bill to the effect that the respondent had ever abandoned the premises covered by its lease, or any part thereof. Furthermore, there was no proof of abandonment and the trial court made no finding that there was any abandonment. The only evidence on the subject was that of the respondent, whose vice-president, Mr. G. O. Moody, testified that the respondent had never abandoned or intended to abandon any part of the premises covered by its lease, and that it was, and had at all times been, ready, willing and able to further develop said premises when the circumstances justified the same.

In the case of *Blackwell Oil & Gas Company, et. al.*, v. *Whited*, 81 Okl. 45, 196 Pac. 688, the Supreme Court of

Oklahoma states the general rule with reference to the abandonment of an oil and gas lease in the following language:

> "To constitute 'abandonment' in respect of property, there must be a concurrence of the intention to abandon, and an actual relinquishment of the property, so that it may be appropriated by the next comer. In determining whether one has abandoned his property rights, the intention is the first and paramount object of inquiry; for there can be no abandonment without the intention to abandon."

To the same effect is the case of *United States* v. *Brown, et al.*, 15 F. (2d) 565, in which Judge KENNAMER said: "To constitute abandonment there must be a coincidence of act and intention and the evidence adduced does not establish a definite intention to abandon."

The petitioners were not entitled to maintain the case at bar for the reason that they neither alleged nor proved that prior to the commencement of the same they properly notified the respondent to drill the additional wells which they claim it was obligated to drill.

The petitioners alleged in their bill that on the 10th day of June, 1926, the following letter was written by Phillip Sauder, the lessor in the lease involved herein, to the Mid-Continent Petroleum Corporation, respondent herein, which letter is attached to their bill, marked "Exhibit B", and reads as follows:

> "I hereby wish to remind you that the time on your lease dated June 6, 1916, on my farm has expired. The lease being for ten years or as long thereafter as oil

or gas can be found in paying quantities. Now this puts it on a paying basis. Either it pays or it don't.

"That is for you to say. If it pays I understand you are supposed *to operate* and if it does not pay I understand the lease is *run out* and I hereby ask you to release it, except that portion which you have operated on and are producing a little oil.

"Please let me know what you will do. I believe I am entitled to some action."

The foregoing letter is the only evidence of notice to or demand upon the respondent herein to further develop the premises involved herein. The respondent admitted that it received the aforesaid letter.

It is thoroughly established by the authorities that a suit to cancel an oil and gas lease for failure to drill "offset" wells or to further develop the leased premises after oil or gas in paying quantities has been discovered thereon, cannot be maintained until the lessor has given the lessee unequivocal and unconditional notice of his intention to declare a forfeiture of the lease if it is not fully developed, and a reasonable time must be given in said notice for future development. However, the most that can be said of the above quoted letter is that it demanded a release of the lease herein involved if said lease was not then producing oil in paying quantities. Said letter certainly was not an unequivocal demand for future development or notice of intention of the lessor to forfeit respondent's lease if it was not further developed.

In the case of *Leeper Oil Company* v. *Rowland*, 39 S. W. (2d) (Ky.) 486, the Court held:

"Giving of unequivocal notice of unconditional de-

mand *to develop* is condition precedent to enforcement of right to forfeit oil lease under doctrine of implied covenant."

See to same effect:

Lawrence Oil Corp. v. *Metcalfe*, 43 S. W. (2d) (Ky.) 986;

Young, et al., v. *Rainey, et al.*, 86 Kan. 296, 119 Pac. 873;

Leeper, et al., v. *Lemon G. Neely Co.*, 193 Fed. (6 C. C. A.) 967;

Wapa Oil and Development Co. v. *McBride*, 84 Okl. 184, 201 Pac. 984;

Papoose Oil Co. v. *Rainey, et al.*, 89 Okl. 110, 213 Pac. 882;

Farmers Mutual Oil Leasing Co., et al., v. *Bonneau*, 110 Okl. 168, 237 Pac. 83.

Applying the foregoing authorities to the case at bar, it is our contention that the aforesaid letter of June 10, 1926, was entirely insufficient to comply with the requirement of an unequivocal notice to the respondent for further development of the premises involved herein.

Contrary to petitioners' contention, an oil and gas lease in Kansas does not convey an interest in real estate.

We are astonished at the assertion of petitioners, in their petition herein for a writ of *certiorari*, that in Kansas "an oil and gas lease conveys an interest in real estate". In said statement they cite *Robinson* v. *Smalley*, 102 Kan. 842, 171 Pac. 1155; *Huston* v. *Cox*, 103 Kan. 73, 172 Pac. 992; and *Brinkman* v. *Empire Gas & Fuel Co.*, 120 Kan. 602, 245 Pac. 107. Instead of these cases supporting the statement of petitioners, they hold the very opposite.

Judge McDermott, in his dissenting opinion herein, likewise erroneously asserts that "an oil and gas lease in Kansas conveys an interest in real estate", citing *Robinson* v. *Smalley, supra.*

In *Robinson* v. *Smalley, supra,* the Court said:

> "While the court has held that an oil and gas lease of the kind under consideration does not constitute a conveyance, will not support a mechanic's lien, does not operate as a grant and severance of mineral in place, *and creates no estate proper in the land itself,* it does create an incorporeal hereditament. A contract for the sale of hereditaments, whether incorporeal or corporeal, is within the sixth section of the statute of frauds. Gen. Stat. 1915, Sec. 4889."

In *Huston* v. *Cox, supra,* the Court held:

> "A lease granting the right to enter on land and to explore for oil and gas, and if it be found in paying quantities, to operate and produce, is not a lease in the strict sense, and creates no estate in the lands, but merely an 'incorporeal hereditament,' which is a right growing out of, or concerning, or annexed to, a corporeal thing, but not the substance of the thing itself."

In the course of the opinion in said case the Court said:

> "In this instance the right granted was exclusive to the grantees, and it is said this fact changed the nature of the grant. The circumstance that the grantors precluded themselves from making other leases does not change the thing the grantees acquired from one of an incorporeal to one of a corporeal nature."

In *Brinkman* v. *Empire Gas & Fuel Co., supra,* which involved a producing oil and gas lease, the Court said:

> "The result of the foregoing is, *there was a contract.* Walker was granted exclusive privilege for 10

years to enter upon, operate for, and procure oil and gas on the Shriver farm. *The nature of the grant is well understood. It was a grant of a profit á prendre.* The grantee might utilize or refrain from utilizing his purchased privilege, subject to the conditions of the grant."

In *Mills* v. *Hartz,* 77 Kan. 218, 94 Pac. 142, the Court said:

"*The lease is not a grant of land, nor of the oil, coal, or gas in the land.* It did not transfer any estate to Mills, and hence some of the rules which he invokes as to nonuser and abandonment do not apply. *Hartz granted him the possession of a part of the land with the right to search for minerals, and gave him an interest in so much of the minerals as might be found and taken out, but, if none were found, no interest in the undiscovered mineral could be acquired by him, and certainly no estate in the land.*"

In *Kansas Natural Gas Co.* v. *Board of Com'rs of Neosho County, et al.,* 75 Kan. 335, 89 Pac. 750, the Court said:

"Such being the scope and purpose of the law, the lease in question brought into existence no state of facts to which it might apply. The lease grants no estate in the land or in the oil or gas which it may contain. It creates an incorporeal hereditament only, a license to enter and explore for oil and gas, and if they are discovered to produce and sever them. *Rawlings* v. *Armel,* 70 Kan. 778, 79 Pac. 683; *Dickey* v. *Brick Co.,* 69 Kan. 106, 76 Pac. 398. Until discovered and brought to the surface, no severance of title occurs. The minerals not only remain a constituent part of the land, but they belong to the owner of the surface soil beneath which they lie. The lessee has no 'right or title' to them (see *Zinc Co.* v. *Freeman,* 68 Kan. 691, 75 Pac. 995), and they are not separately taxable to him."

In *Phillips* v. *Springfield Crude Oil Co., et al.*, 76 Kan. 783, 92 Pac. 1119, and *Martin* v. *Springfield Crude Oil Co., et al.*, 77 Kan. 851, 92 Pac. 1119, it was held "that a mechanic's lien will not attach to the interest acquired in lands by the lessee under an ordinary oil and gas lease, *notwithstanding oil or gas is discovered.*"

In the chapter in Summers on Oil & Gas (published 1927) dealing with the nature of a lessee's interest under an oil and gas lease, page 187, the author, citing numerous Kansas cases in support thereof, says:

> "In Kansas the court of that state has held, apparently without any regard to the type of the granting clause, that an oil and gas lease creates a license, incorporeal hereditament, or *profit á prendre*. There is practically no explanation in the cases as to the sense in which the above terms are used, or the reasons for the court's view as to the incorporeal nature of the interest created. The statement found in *Funk* v. *Haldeman*, to the effect that the lessee acquired no estate in the land, or in the oil and gas, by virtue of an oil and gas lease, occurs in substance in several Kansas cases. It has been held that an oil and gas lease does not create a leasehold, or any estate in land, as distinguished from a license, within the meaning of the mechanic's lien statute. But it is held that the interest created is of such a character that it is an alienation within the meaning of the homestead statute, and must be in writing under the statute of frauds. Perhaps the most litigation in Kansas involving the nature of the interest created by oil and gas leases has been in connection with the matter of taxation. A statute provided that, where 'the right or title to any minerals' in land were in one person and the fee to the surface of the same land in another person, the 'right to such minerals' be separately taxed. Under this statute the Kansas

court in several cases held, without regard to the nature of the granting clause, that leases did not create separate estates in the land, or in oil and gas, subject to taxation. The question has never been tested by ejectment, but in a case where a co-lessee brought an action of ejectment and partition the court remarked that the action of ejectment was not taken seriously by either of the parties, and the partition suit could not be maintained, because the interest created was not real estate."

Since filing their petition for writ of *certiorari,* the petitioners seem to have undergone a change of mind with reference to the nature of an oil and gas lease in Kansas, for in their brief they now say: "* * * an oil and gas lease may not convey what is technically described as an estate in land." It seems now to be their position that under the Kansas law such an instrument merely grants rights in connection with property having a "definite and fixed location", to-wit: land.

An examination of the authorities cited in petitioners' brief relative to the instant contention will, we think, disclose that none of them conflicts with what we have hereinbefore said with respect to the nature of an oil and gas lease under the Kansas decisions. On the contrary, there is much in said citations which very definitely supports our contention.

Inasmuch as the nature of the interest of an oil and gas lessee in Illinois is decidedly different from what it is in Kansas, the case of *Guffey* v. *Smith,* 237 U. S. 101, 59 L. ed. 856, is distinguishable from the case at bar. In that case Mr. Justice VAN DEVANTER said:

"It is settled by the decisions of the Supreme

Court of Illinois that an oil and gas lease like that of the complainants passes to the lessee, his heirs and assigns, a present vested right—'a freehold interest'—in the premises, that this interest is taxable as real property, and that the clause giving the lessee an option to surrender the lease at any time is valid, does not create a tenancy at will or give the lessor an option to compel a surrender, and does not make the lease void as wanting in mutuality. *Bruner* v. *Hicks,* 230 Ill. 536, 540, 542, 120 Am. St. Rep. 332, 82 N. E. 888; *Watford Oil & Gas Co.* v. *Shipman,* 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53; *Poe* v. *Ulrey,* 233 Ill. 56, 62, 64, 84 N. E. 46; *Ulrey* v. *Keith,* 237 Ill. 284, 298, 86 N. E. 696; *People, ex rel. Carrell,* v. *Bell,* 237 Ill. 332, 339, 19 L. R. A. (n.s.) 746, 86 N. E. 593, 15 Ann. Cas. 511; *Daugherty* v. *Ohio Oil Co.,* 263 Ill. 518, 524, 105 N. E. 308. These decisions constitute rules of property and must be accepted and applied in passing upon the complainants' rights."

Guffey v. *Smith* is further distinguishable from the case at bar in that its purpose was to prevent the owner of an interest in real property from being deprived thereof by a trespasser, whereas the case at bar only involves the question as to whether respondent has breached an implied obligation of a contract.

Since none of the foregoing Kansas cases involved the precise facts involved in the case at bar, the Circuit Court of Appeals was not bound thereby.

As heretofore pointed out, in not a single one of the Kansas cases relied on by the petitioners did the evidence disclose that if additional wells had been drilled on the premises involved therein said wells would not have produced oil or gas in paying quantities, or that a reasonably

prudent operator would not have drilled an additional well or wells thereon. Moreover, it does not appear that the defendant in any of said cases resisted the plaintiff's action to cancel his lease or the undeveloped portion thereof upon the ground that it would have in all probability been unprofitable to have drilled an additional well or wells upon the leased premises. Consequently, none of said cases presented the precise facts involved in the case at bar.

In *John Deere Plow Co.* v. *Mowry,* (6 C. C. A.) 222 Fed. 1, the Court held:

> "'It is only to a settled rule of a state court applicable to the precise facts disclosed by the record that a federal court should yield its own judgment.'"

Since the lease involved herein was executed and the rights of the respondent accrued thereunder prior to the only Kansas case, to-wit, *McCarney v. Freel, supra,* which can be said to conflict with respondent's contention, the Circuit Court of Appeals was not required to follow said case.

The case of *McCarney* v. *Freel, supra,* was decided June 12, 1926, and the lease involved herein was executed on the 6th day of June, 1916.

In 25 Corpus Juris, at page 843, section 179, the following general rule is stated:

> "When contracts and transactions have been entered into and rights have accrued thereon under a particular state of decisions, or when there has been no decision of the state tribunals, the federal courts will adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the state courts after such rights have accrued. * * *"

In the case of *Barton V. Kuhn* v. *Fairmont Coal Company,* 215 U. S. 348, 54 L. ed. 229, this Court held as follows:

> "A decision of the highest state court that the grantor in a deed conveying the coal under a tract of land, with the right to excavate, and remove all of the coal, cannot maintain an action for damages in tort, founded upon the failure of the grantee or his successors to leave sufficient support to the overlying or surface land, is not binding upon the federal courts in a similar action based on almost identical facts and circumstances, the granting clause of the two deeds being in fact identical, where such decision was handed down after the deed upon which the defendant relies was executed, and after the injury complained of was sustained, and the action begun, and where the point decided had not been previously adjudged by the state Supreme Court."

In the case of *Denker* v. *Mid-Continent Petroleum Corporation,* 56 F. (2d) 725 (10 C. C. A.), deciding the identical question involved herein, it was held:

> "Decisions construing oil leases decided after lease involved was executed, *held* persuasive only."

In *Mothersead, State Bank Com'r of Oklahoma,* v. *United States Fidelity & Guaranty Co.,* 22 F. (2d) 644 (8 C. C. A.), it was held:

> "Decision rendered by the highest state court after rights and liabilities of parties under contracts involved in federal court suit have fully accrued is not binding on federal courts as a rule of decision."

In *Butte & Superior Copper Co.* v. *Clark-Montana Realty Co., et al.,* (9 C. C. A.) 248 Fed. 609, affirmed 249 U. S. 12, 63 L. ed. 447, the Court said:

"Decisions of the Montana state court as to the validity of mining locations are not precedents binding on the federal courts in a suit involving the validity of locations in that state made prior to the rendition of such decisions of the Montana court."

The matter of construing an oil and gas lease is a matter of general law concerning which the federal courts will reach their own conclusion.

Oil and gas leases such as the one involved herein are by no means peculiar to the State of Kansas. On the contrary, substantially the same form of lease is and has been for many years in general use in all of the oil producing states of the Union. Consequently, uniformity as to the construction of the obligations of a lessee under such a lease is of great importance to the oil industry. And it would seem that the mere matter of construing and defining either the express or the implied covenants of such an instrument is a matter of general law, as much so as the matter of construing and defining either the express or implied covenants of any other contract of general use throughout the United States. The fact that the contract happens to relate to property having a fixed and definite situs should make no difference, particularly in view of the Kansas decisions with respect to the nature of an oil and gas lease.

A question quite similar to the one involved in the case at bar was before this Court in the case of *Black & White T. & T. Co.* v. *Brown & Yellow T. & T. Co.*, 277 U. S. 518, 72 L. ed. 681. There a railroad company by a written instrument or contract granted to a transfer company certain exclusive privileges at its station in Bowling

Green, Kentucky, and the question was whether same was against public policy. The contract related solely and exclusively to property having a fixed and definite situs in the State of Kentucky, and the term thereof was fixed at one year, to continue for consecutive yearly periods until terminated by either party on 30 days' notice. The complaint alleged that the railroad company had failed to carry out the contract, in that it allowed others to enter upon the property involved and to exercise the privileges granted exclusively to the transfer company. The courts of Kentucky had held such contracts invalid, but this Court held it was not bound by such decisions. In the opinion by Mr. Justice BUTLER, it was said:

> "The contract gives respondent, subject to termination on short notice, license or privilege to solicit patronage and park its vehicles on railroad property at train time. There is no question concerning title to the land. * * * As respects the rule of decision to be followed by federal courts, distinction has always been made between statutes of a state and the decisions of its courts on questions of general law. The applicable rule sustained by many decisions of this court is that in determining questions of general law, the federal courts, while inclining to follow the decisions of the courts of the state in which the controversy arises, are free to exercise their own independent judgment. That this case depends on such a question is clearly shown by many decisions of this court."

In *Swift* v. *Tyson*, 41 U. S. 1, 10 L. ed. 865, Mr. Justice STORY, in referring to the thirty-fourth section of the Judiciary Act of 1789, said:

> "It never has been supposed by us, that the section did not apply, or was designed to apply, to ques-

tions of a more general nature, not at all dependent upon local statutes or local usages of a fixed and permanent operation, as, for example, *to the construction of ordinary contracts or other written instruments,* and especially to questions of general commercial law, where the state tribunals are called upon to perform the like functions as ourselves, that is, *to ascertain upon general reasoning and legal analogies, what is the true exposition of the contract or instrument,* or what is the just rule furnished by the principles of commercial law to govern the case."

In *Kuhn* v. *Fairmont Coal Co.*, 215 U. S. 348, 54 L. ed. 229, the Court said:

"'In *Foxcroft* v. *Mallett*, 4 Hod. 353, 379, 11 L. ed. 1008, 1019, the object of the action was to recover certain land in Maine. The case turned in part on the construction to be given to a mortgage of certain land to Williams College, and to local adjudications relating to those lands, which, it was contended, were conclusive on the parties. 'But,' this court said, 'on examining the particulars of the cases cited to govern this (*Williams College* v. *Mallett*, 12 Me. 398; *Williams College* v. *Mallett*, 16 Me. 84; *Randell* v. *Mallett*, 14 Me. 51), it will be seen that the construction of the mortgage to the college, in respect to this reservation or condition, never appears to have been agitated. *If it had been,* the decision would be entitled to high respect, though it should not be regarded as conclusive *on the mere construction of a deed as to matters and language belonging to the common law, and not to any local statute. Williams* v. *Suffolk Ins. Co.*, 3 Sumn. 270, 277, Fed Cas. No. 17738.'

"In *Russell* v. *Southard*, 12 How. 139, 147, 14 L. ed. 927, 930, the controlling question was whether, in any case, it was admissible to show by extraneous evidence that a deed on its face of certain real estate in Kentucky was really intended by the parties as a security for a loan and as a mortgage. The court, speak-

ing by Mr. Justice CURTIS, after citing adjudged cases sustaining the proposition that evidence of that kind was admissible in certain states, said: 'It is suggested that a different rule is held by the highest court of equity in Kentucky. If it were, with great respect for that learned court, this court would not feel bound thereby. This being a suit in equity, and oral evidence being admitted or rejected, not by the mere force of any state statute, but upon the principles of general equity jurisprudence, this court must be governed by its own views of those principles'—citing *Robinson* v. *Campbell*, 3 Wheat. 212, 4 L. ed. 372; *United States* v. *Howland*, 4 Wheat. 108, 4 L. ed. 526; *Boyle* v. *Zacharie*, 6 Pet. 658, 8 L. ed. 536; *Swift* v. *Tyson*, 16 Pet. 1, 10 L. ed. 865; *Foxcroft* v. *Mallett*, 4 How. 379, 11 L. ed. 1019.

"In *Yates* v. *Milwaukee*, 10 Wall. 497, 506, 19 L. ed. 984, 987, the question was as to the nature and extent of the right of an owner of land in Wisconsin, bordering on a public navigable water, to make a landing, wharf, or pier for his own use or for the use of the public. There was a question in the case of dedication to public use, and the City of Milwaukee sought to change or remove the wharf erected by the riparian owner in front of his lot. This court, speaking by Mr. Justice MILLER, said: 'This question of dedication on which the whole of that case turned, was one of fact, to be determined by ascertaining the intention of those who laid out the lots, from what they did, and from the application of general common-law principles to their acts. This does not depend upon state statute or local state law. The law which governs the case is the common law, on which this court has never acknowledged the right of the state courts to control our decisions, except, perhaps, in a class of cases where the state courts have established, by *repeated decisions, a rule of property* in regard to land titles peculiar to the state.'

"In *Louisville Trust Co.* v. *Cincinnati*, 22 C. C. A. 334, 338, 341, 47 U. S. App. 36, 45, 51, 76 Fed. 296, 300,

304, which was a suit by a Kentucky corporation, it became necessary to determine the force and effect of a mortgage originating in a state statute of Ohio and certain municipal ordinances covering street easements in Cincinnati. The state court, in a suit to which the trustee in the mortgage was not a party, passed a decree declaring the scope, effect, and duration of contracts or ordinances under which the mortgage, easements and franchises originated. It was insisted that the federal court was bound to accept the views of the state court. But the Circuit Court of Appeals, held by Judges TAFT, LURTON and HAMMOND, ruled otherwise. Judge LURTON, speaking for all members of that court, made an extended review of the authorities, and observed that if the state decision was regarded as conclusive upon the parties, 'the constitutional right of the complainant, as a citizen of a state other than Ohio, to have its rights as a mortgagee defined and adjudged by a court of the United States, is of no real value. If this court cannot for itself examine these street contracts and determine their validity, effect and duration, and must follow the interpretation and construction placed on them by another court in a suit begun *after its rights as mortgagee had accrued, and to which it was not a party,* then the right of such a mortgagee to have a hearing before judgment and a trial before execution is a matter of form without substance. The better forum for a suitor so situated would be a court of the state. * * * The validity, effect and duration of the street easements, granted or claimed under these laws and ordinances is a question which this complainant is entitled to have decided by the courts of the United States, and the opinion of the Supreme Court of Ohio, while entitled to the highest respect as a tribunal of exalted ability, can be given no greater weight or respect than its reasoning shall demand, where the contract rights of a citizen of another state are involved, who was neither a party nor privy to the suit in which that opinion was delivered. The special fact,

therefore, which justifies us in determining for ourselves the true meaning and validity of the Ohio statutes and city ordinances out of which the rights of this complainant spring is the fact that it is a citizen of another state, and that the contract under which it has acquired an interest originated prior to the judicial opinion relied upon as foreclosing our judgment'."

In *Midland Valley R. Co.* v. *Jarvis*, 29 F. (2d) (8 C. C. A.) 539, a proceeding by the railroad company to enjoin a lessee of land subject to the railroad's right-of-way from erecting any structures, drilling for oil on the premises or using them for anything which would interfere with the railroad in its present or future use of its right-of-way, the Court held that *the extent of the use and enjoyment possessed by the railroad company in its right-of-way is a question of general law*, which is not controlled in federal courts by the decisions of the courts of the state in which the right-of-way is located.

The same state of facts was involved and the same conclusion was reached in *Midland Valley Railroad Co.* v. *Sutter*, 28 F. (2d) (8 C. C. A.) 163, and in 280 U. S. 521, 74 L. ed. 590, this Court dismissed the writ of *certiorari* therein.

Since the relief sought herein is wholly in equity, the Circuit Court of Appeals was not bound by any Kansas decisions.

The sole question in the case at bar is whether or not the petitioners are entitled to a cancellation of respondent's lease by reason of the alleged breach of the implied covenant thereof to reasonably develop the leased premises. There is no question of the validity of the oil and gas lease,

or of the title to or interest in land acquired by the lessee thereunder, involved herein. And the question whether or not there has been such a breach of either the express or the implied covenants of an oil and gas lease as to entitle the lessor to a cancellation thereof is purely an equitable question, depending for its decision upon the general principles of equity jurisprudence, and it is well established that federal courts are not bound to follow decisions of state courts on such questions.

Section 34 of the Judiciary Act of 1789 (now Rev. Stat., Sec. 721, U. S. C. A., Title 28, Sec. 725), relates exclusively to "trials at common law."

In *Bucher* v. *Cheshire Railroad Co.*, 125 U. S. 555, 31 L. ed. 795, the Court said:

> "The language of the statute limits its application to cases of trials at common law. There is, therefore, nothing in the section which requires it to be applied to proceedings in equity, or in admiralty; nor is it applicable to criminal offenses against the United States —see *U. S.* v. *Reid*, 53 U. S. 2 How. 361 (13:1023)—or where the Constitution, treaties or statutes of the United States require other rules of decision."

In *Brill* v. *W. B. Foshay Co., et al.*, 65 F. (2d) (8 C. C. A.) 420, the Court held:

> "State laws do not constitute rule of decision in federal equity courts."

In said case the complainant, receiver for Foshay Investors' Corporation, a Minnesota corporation, brought suit against the receiver of W. B. Foshay Company, a Delaware corporation, to impress a lien upon the assets of said Delaware corporation in favor of creditors of the Min-

nesota corporation. The Delaware corporation was organized for the sole purpose of taking over the assets and conducting the business of the Minnesota corporation. At the time of the conveyance of the assets of the Minnesota corporation to the Delaware corporation, the liabilities of the Minnesota corporation exceeded the assets thereof. The contention of the complainant was that under the Minnesota statutes, the conveyance by the Minnesota corporation to the Delaware corporation was fraudulent and void as to creditors, and that the creditors of the Minnesota corporation had a prior claim to the assets of the Delaware corporation over the creditors of the Delaware corporation. In the body of the opinion the Court said:

> "It is, however, urged that the Minnesota statute contains no exceptions, and hence, based upon the letter of the statute, regardless of the equities involved, plaintiff is entitled to have the transfer set aside and the property devoted to the payment of the debts of the Minnesota company in preference to or exclusion of the creditors of the Delaware company. To so hold would be so inequitable and harsh as to shock the conscience of the chancellor, and we cannot accede to this contention. Equity will not lend its aid to one whose sole ground for seeking such aid is based upon a technicality. Only a part of the property transferred had a situs in the State of Minnesota. *State laws do not constitute a rule of decision in federal courts of equity.* The equitable jurisdiction of federal courts is that which was exercised by the High Court of Chancery in England at the time of the adoption of the Constitution, and the passage of the original Judiciary Act, unless subsequently changed or enlarged by Act of Congress. This jurisdiction is administered uniformly throughout all the states, and furnishes one and the same rule of decision for federal courts of equity, and

state laws do not ordinarily constitute a rule of decision binding on federal courts of equity. *Hollins* v. *Brierfield Coal, etc., Co.*, 150 U. S. 371, 14 S. Ct. 127, 37 L. ed. 1113; *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 43 S. Ct. 454, 67 L. ed. 763; *Cates* v. *Allen*, 149 U. S. 451, 13 S. Ct. 883, 37 L. ed. 804; *Scott* v. *Neely*, 140 U. S. 106, 11 S. Ct. 712, 35 L. ed. 358; *Smith* v. *Ft. Scott, etc., R. Co.*, 99 U. S. 398, 25 L. ed. 437; *Neves* v. *Scott*, 13 How. 268, 14 L. ed. 140; *Harrison* v. *Farmers' L. & T. Co.*, (C. C. A. 5) 94 F. 728; *Hall* v. *Gambrill*, (C. C. A. 4) 92 F. 32. Where the application of a state statute to the facts of a case will violate the fundamental principles of equity, a federal court of equity should not enforce the letter of such a statute."

In the case of *Lyon, et al.*, v. *Union Gas & Oil Co., et al.*, 274 Fed. 957, the United States District Court for the Eastern District of Kentucky held:

"The decision of the state court that equity would enforce the forfeiture of an oil and gas lease for failure to develop after reasonable notice is one affecting the right to relief in equity, which is not binding on the federal court, especially where the decision was a *dictum*, and a statute had since been enacted establishing the contrary rule."

During the course of the opinion in said case, Judge COCHRAN said:

"It seems to me that, if that doctrine is to prevail, it is decidedly questionable whether the notice given here was a reasonable one, only 3 months, and the lease contemplated an annual rental payment. It may be that, if that doctrine applies, there ought to be a year's notice. At any rate, the burden was on the plaintiff to show that that was a reasonable time, and it is extremely doubtful, to say the least of it, whether or not they made out that a reasonable time had elapsed. However

that may be, I do not think that I am controlled by the decision of the Kentucky Court of Appeals in the *Monarch* case. The Kentucky Court of Appeals has never actually applied that doctrine to a single solitary case. Never has a lease been forfeited by that court upon a notice requiring development. The statement of the Court of Appeals that a forfeiture can be brought about in this way is pure *dictum*. As stated, never yet has a case been decided by them where a lease has been declared forfeited upon a notice.

"Furthermore, I do not think that *dictum* is sound. According to the very terms of the lease, delay in development is authorized on the payment of the rental. For a court to forfeit a lease on failure to develop on notice is to change the contract of the parties. If the legislature were to pass a law saying or providing that in a lease of this character development might be hastened by giving notice, it would be in violation of the constitutional provision that inhibits the legislature passing a law impairing the obligation of a contract. Then, in March, 1920, the legislature passed an act overthrowing that doctrine, saying that no lease could be forfeited in that way. So it is no longer a doctrine in Kentucky that a lease can be forfeited in that way. But I do not think that, if that statute had never been passed, I would be bound to follow that *dictum* of the Court of Appeals. All that is involved is a question of equitable relief. The Supreme Court of Illinois had held that it was not equitble to enforce a lease if it had a surrender clause in it, and yet the Supreme Court of the United States, in the case of *Guffey* v. *Smith*, 237 U. S. 101, 35 Sup. Ct. 526, 59 L. ed. 856, decided that the federal court was not bound by that decision—that the federal court would enforce a lease containing a surrender clause—on the ground that it was a matter of relief in equity, and in a matter of that sort federal courts are not bound by state courts."

In the case of *Guffey* v. *Smith*, 237 U. S. 101, 59 L. ed. 856, Mr. Justice VAN DEVANTER, speaking for the Court, said:

> "The Supreme Court of Illinois, while fully sustaining the right to maintain such a suit in the courts of the state when the lease contains no clause giving the lessee an option to surrender it (*Gillespie* v. *Fulton Oil & Gas Co., supra*), holds that the presence of such a clause in the lease operates to prevent the lessee from directly or indirectly enforcing it in equity (*Watford Oil & Gas Co.* v. *Shipman*, 233 Ill. 9, 13, 14, 122 Am. St. Rep. 144, 84 N. E. 53, and *Lorey* v. *Keith*, 237 Ill. 284, 298, 86 N. E. 696), the ground of distinction being that the surrender clause, although lawful in itself, and not affecting the validity of the lease, renders it so lacking in mutuality that equity will remit the lessee to his remedy at law. These decisions, it is insisted, should have been accepted and applied by the Circuit Court. To this we cannot assent. By the legislation of Congress and repeated decisions of this court it has long been settled that the remedies afforded and modes of proceeding pursued in the federal courts, sitting as courts of equity, are not determined by local laws or rules of decision, but by general principles, rules and usages of equity having uniform operation in those courts wherever sitting. Rev. St., Secs. 913, 917; Comp. Stat. 1913, Secs. 1536, 1543; *Neves* v. *Scott*, 13 How. 268, 272, 14 L. ed. 140, 142; *Payne* v. *Hook*, 7 Wall. 425, 430, 19 L. ed. 260; *Dodge* v. *Tulleys*, 144 U. S. 451, 457, 36 L. ed. 501, 503, 12 Sup. Ct. Rep. 728; *Mississippi Mills* v. *Cohn*, 150 U. S. 202, 204, 37 L. ed. 1052, 1053, 14 Sup. Ct. Rep. 75. As was said in the first of these cases: 'Whenever a case in equity may arise and be determined, under the judicial power of the United States, the same principles of equity must be applied to it, and it is for the courts of the United States, and for this court in the last resort, to decide what those principles are, and to apply such of them to each particular case as they may find justly applicable'."

In the case of *City of Dallas* v. *Higginbotham-Bailey-Logan Co.*, 37 F. (2d) 513, the Circuit Court of Appeals for the Fifth Circuit held:

> "A federal court siting in equity is not bound by decisions of state courts."

If the Kansas decisions are in conflict by reason of *McCarney v. Freel, supra,* or are not clear and definite upon the precise question involved herein, the Circuit Court of Appeals was not required to follow said decisions.

That the Kansas decisions relied upon by the petitioners are not clear and definite upon the precise question involved herein is manifest from the conflict between the judges of the Circuit Court of Appeals herein with respect to their understanding of the applicability of said decisions, as well as that between opposing counsel herein. On the one hand, the majority of the Circuit Court of Appeals and counsel for respondent find nothing in said decisions which conflicts with the universal rule under consideration. On the other, Judge McDermott and counsel for petitioners seem to think otherwise. However, it is to be noted that Judge McDermott seems to entertain some doubt as to his interpretation of the Kansas decisions. He says, "if I am right in this analysis of the Kansas decisions," and, "if I am wrong in my construction of the earlier Kansas decisions." It, therefore, cannot be said that the Kansas decisions are clear and definite upon the precise question involved herein.

Likewise, the petitioners seem to be doubtful as to their construction of the Kansas decisions, for in their brief they

say, "if we do not construe correctly the Kansas decisions, the question was at least an open one."

The above proposition is fully sustained by the case of *Concordia Ins. Co. v. School Dist.*, 282 U. S. 545, 75 L. ed. 528, in which this Court said:

> "The general rule that a federal court will follow the decisions of the highest court of a state construing a state statute is, of course, well established. The difficulty here is that, prior to the judgment of the federal district court in this case allowing interest, the decisions of the Supreme Court of Oklahoma were in such confusion that the view of that court in respect to the meaning of the statute, as applied to the present case, could not definitely be determined."

Likewise, in *Edward Hines Yellow Pine Trustees v. Martin*, 268 U. S. 458, 69 L. ed. 1050, it was held:

> "When questions affected by the interpretation of a state statute or a local rule of property may arise in a federal court, that court has the same authority and duty to decide them as it has to decide any other questions which arises in a cause; *but where state decisions are in conflict, or do not clearly establish what the local law is,* the federal court may exercise an independent judgment and determine the law of the case."

In each of the decisions of this Court holding that the Federal Court was bound by the state court decisions that we have examined it appears that, unlike the case at bar, there was no controversy with respect to what the state court decisions held.

Criticism of Some of Petitioners' Comments on the Evidence.

The petitioners state that no producing well has been drilled closer to the premises involved than 400 feet, except the wells offsetting the two wells on said premises, when, as a matter of fact, no well, other than said offset wells, has been drilled closer than 660 feet. (Ex. 1, R. 67.)

The petitioners, in several places in their brief, state in effect that the respondent and its predecessors in title never drilled any "exploratory" well upon the premises involved, and that the two wells which they drilled had to be drilled by reason of the existence of offset wells on adjacent premises. If this were true, which it is not, it would be immaterial. Judge McDermott in his dissenting opinion herein commits the same error. Suffice it to say that well No. 2 on the premises involved was completed prior to the offset well on the adjacent premises and was, therefore, an exploratory well. (Ex. 1, R. 67.)

Both the petitioners and Judge McDermott state in effect that the respondent took the position that it would not drill an additional well or wells upon the premises involved unless some other operator drilled a well in the vicinity of the land involved which would demonstrate that it would pay to drill such additional well or wells. Under the authorities the respondent would be fully justified in taking such position, but as a matter of fact its position was not so limited. Respondent's vice-president, Mr. Moody, testified that respondent "had never abandoned any portion of the lease involved and had never intended to abandon any portion of it, and that if the future should prove it practical to drill another well on said lease the Mid-Continent Petroleum Corporation was capable and willing to drill it" (R.

51). He further testified that the lease involved was worthless from the standpoint of further development, "unless future development proved that defendant's theories were wrong"; that "by future development he meant that if there was any development in the vicinity that showed defendant's present theory of operation was wrong; that if some other company does any drilling in the vicinity which indicates that there might be oil on the land involved, the defendant would drill an additional well or wells on said land"; that respondent's geological records did not show that it was impossible for further development in the northwest corner of the lease involved, and "that if it was later developed that production could be obtained there defendant would be perfectly willing to develop further on the lease involved; that before there was any further development on the lease involved the defendant would have to gain further information; and that further information would be obtained by geology and drilling wells to the northwest" (R. 52). And we would also call attention to the following answes of Mr. Moody to questions propounded to him by the trial court:

> "By the Court: Somebody else would have to develop it?
>
> "A. We would have to gain further information than we have.
>
> "By the Court: How would you get that?
>
> "A. Geology.
>
> "By the Court: Your theory and your contention and the purpose of your company, is to hold this lease without any further development, or until somebody else develops something that might indicate to you—(interruption).
>
> "A. Or we gain further information ourselves." (R. 53)

The petitioners, repeatedly, and Judge McDermott, at least once, state that under the circumstances respondent "in all fairness" should give up the undeveloped portion of the lease involved and "let some one else drill it." We submit, however, that there is not a scintilla of evidence in the record to the effect that any reasonably prudent operator would drill a well upon said portion of said lease, much less that there was any one who had indicated to the petitioners, or any one else, that he was actually willing to drill such well. We might also reply that if there was some one who was actually willing to drill a well upon said premises, or even that a reasonably prudent operator would have drilled such well, it would have been quite simple for petitioners to have shown the same, and "in all fairness" they were required to do so. Furthermore, it is significant that there is no evidence that if the lease involved were cancelled petitioners would be able to procure another lessee.

The petitioners take issue with the testimony of respondent's vice-president, Mr. Moody, "that the average rate of earning produced by" the lease involved, "on the basis of expenditures, was approximately 5.1% per annum," which he said was a very small return for an oil venture. The aforesaid rate of earning is obviously arrived at by dividing the total profits of $26,229.21 by eleven, the number of years over which said profits accumulated, and then dividing the total expenditures of $46,464.97 into the annual profits, and of course was not intended to be technically correct. However, we submit that said rate of earning was more nearly correct than the 18.2% suggested by petitioners. Said figure of 18.2% was arrived at by petitioners without deducting the cost and expense of drilling and equipping the

two wells on the lease involved from the gross income, less only the estimated total costs of operation, and merely represents *the annual rate of return of respondent's expenditures* in drilling and equipping said two wells, and not *the rate of earning* on investment.

The confusion of petitioners, as well as Judge McDermott, is, in our opinion, due to the fact that the record discloses a very large number of wells drilled in the vicinity of the lands involved. This, however, is a mere circumstance which, in and of itself and without more, means nothing. It is a well known fact that there are fields in which a producing well can be drilled at almost any location and yet only a few of the wells drilled can be said to produce oil in paying quantities. Furthermore, the mere fact that a producing well has been drilled and is being operated is no indication that it is a paying well, for the operator may merely be taking such oil as he can get with the sole idea of minimizing his ultimate loss, but with no hope at all of making any profit on his total outlay. Consequently, the burden was upon the petitioners to establish that if an additional well were drilled upon the premises involved it not only would probably produce oil, but that it would probably produce it in such quantities as to yield a profit on the total cost of drilling, equipping and operating. And it may be suggested with respect to the large number of wells drilled in the vicinity of the lands involved herein that, while the initial production of some of said wells is shown, there is no evidence of the total amount of oil produced from any of them, nor is there any evidence that any of said wells, except several hereafter referred to, has ever repaid, or will ever repay, the total outlay in connection therewith. The

Court should, therefore, not be misled by reason of the large number of wells drilled in the vicinity of the lands involved.

Judge McDermott concedes and petitioners do not deny that the Bartlesville sand "pinched out" before it reached the premises involved, which conclusion is inescapable under the uncontradicted testimony, so that in the consideration of production on adjoining acreage we may wholly disregard wells producing from said sand (R. 97).

The petitioners and Judge McDermott state that the lime under the undeveloped portion of the lease involved was between 570 and 610 feet below sea level, and, referring to respondent's Exhibit E, state that on the section adjoining said lease on the southwest there were 23 producing wells where the lime was between 570 and 610 feet, and 9 higher than 570 feet, and 18 producing wells to the northeast within the 570 and 610 feet range, and 3 higher than 570 feet. From this they argue that the oil *could be produced* from the undeveloped portion of the lease involved. But conceding that oil *could be produced* therefrom, *no one says that the same could be produced in paying quantities* (B. 60, R. 97-98).

Moreover, an examination of the aforesaid Exhibit E discloses that all of the undeveloped portion of the lease involved lies between 580 and 610 feet below sea level, the greater portion being between 590 and 610 feet. Therefore, petitioners and Judge McDermott are in error when they state that the lime under said portion of said lease lies between 570 and 610 feet (R. 72a).

Further examination of said Exhibit E discloses that on the section to the southwest of the lease involved the deepest producing wells were 599 feet below sea level and

that 2 wells thereon, at 600 feet and 604 feet, respectively, were dry holes. And it is significant that no one contends any of said wells below 570 feet produced oil in paying quantities. With reference to the wells to the northeast of the lease involved, the deepest point at which the lime was encountered was 599 feet below sea level, and the lime in the majority of the said wells was above 580 feet (R. 72a).

The only evidence to the effect that any of the approximately 227 wells drilled on the lime on and in the vicinity of the lease involved ever produced oil in paying quantities was the testimony of Mr. Moody to the effect that the wells on the Northwest Quarter of Section 21, 3 of which were above 570 feet and had an initial production of 75, 60 and 65 barrels per day, respectively, had paid a small return on the investment, and that the two wells on the lease involved had produced oil in paying quantities (R. 48-49). It is absolutely impossible from the record to state that any other of said lime wells was a paying well. Furthermore, all of the witnesses who testified, knowing the results of the production in the Northwest Quarter of Section 21, the results of the production on the lease involved, and also probably knowing the results of the remaining lime wells, stated that they would not expect to find oil in paying quantities under any of the undeveloped portion of the lease involved. Mr. Brown, a wholly disinterested witness, testified that it would be necessary to find oil in lime wells in greater quantities than it had been discovered on the Northwest Quarter of Section 15, just east of the lease involved, to produce oil in paying quantities (R. 65). And an examination of the aforesaid Exhibit E and petitioners' Exhibit 1 discloses that one of the lime wells on said Northwest Quarter of Section

15 had an initial production of 35 barrels per day, and that the other two had an initial production of 5 and 10 barrels per day, respectively (R. 72a, 66a).

The respondent has never made the contention that no oil whatsoever could be produced from the undeveloped portion of the premises involved. Its position, which is supported by all the evidence, is that oil could not be produced therefrom *in paying quantities.* There is not a single circumstance in the entire record in the least inconsistent with the respondent's witnesses' testimony that in their opinion oil could not be produced in paying quantities from said premises. As before stated, the mere existence of a great number of producing wells in the oil field surrounding said premises, *in the absence of a clear showing that said wells produced oil in paying quantities,* is no evidence at all that oil could be produced from said premises in paying quantities, and this is especially true in the face of the testimony of the expert witnesses, with all of that development in mind, that they would not expect to find oil in paying quantities on said premises, and that a reasonably prudent operator would not drill a well thereon.

Respondent's Exhibit E further discloses that there were 24 wells drilled on lands surrounding those involved herein in which the lime was encountered at 600 feet and deeper below sea level, only 3 of which produced any oil. In other words, 88% of said wells were dry holes. Of the 31 wells between 590 and 599 feet below sea level, 41% thereof were dry holes. The initial production of 3 of the wells within that range was 25 barrels per day at 591 feet, 15 barrels per day at 594 feet, and 5 barrels per day at 599 feet (R. 72a). It is, therefore, obvious that an oil operator would

hardly invest $15,000.00 or $16,000.00 to drill a well, where the chances were over 50% that he would get a dry hole, with the largest producer he could hope for having an initial production of less than 25 barrels per day.

By considering respondent's Exhibit E with petitioners' Exhibit 1 we find that the average initial production of the lime wells on the Northwest Quarter of Section 21 was approximately 34 barrels per day, and that the average initial production of the two wells on the lease involved was 47.5 barrels per day. *These are the only two leases producing lime oil which the record discloses ever paid out, and they paid only a slight profit on the investment.* The closest lime producing wells to the northeast of the lease involved had an initial production of 10 and 15 barrels per day, respectively, and the largest producer, over 1/2 mile away, had an initial production of 25 barrels per day. Furthermore, there was a dry hole directly offsetting the lease involved to the west, and a dry hole 630 feet west of said lease and 290 feet north of the center line of Section 16, a dry hole to the north of said lease, a well on the Northeast Quarter of Section 21, south of said lease, which never paid out, and no evidence that any or all of the wells to the northeast of said lease ever paid out. So that every circumstance in the record absolutely corroborates the testimony of all of the experienced oil men who testified in the case at bar to the effect that oil could not be produced from the undeveloped portion of said lease in paying quantities (R. 72a, 66a).

The petitioners claim there is a trend of oil producing lime from the southwest corner of the lease involved to the northeast corner thereof, but respondent's Exhibit E dis-

closes that if there is any trend at all with respect to wells to the southwest of said lease said trend runs from the south almost straight north through the West Half of Section 16, and with respect to the wells to the northeast of the lease involved, if those wells are in any trend they are in a trend running from the southeast to the northwest, which entirely misses the northeast corner of the lease involved (R. 72a).

The petitioners assert that there was some probability of drainage from the lease involved and contend that the trial court's finding of fact with respect to drainage was sufficient to justify cancellation of said lease. The trial court, however, did not find that there was any drainage. It merely found that it was impossible to determine whether or not there was any drainage, without the drilling of test wells, and that there was a probability of drainage (R. 34-35). This was far short of a finding of a certain and substantial breach of the implied covenant to protect the premises involved from drainage. Furthermore, there is no evidence in the record that there was any drainage, and the testimony of all the witnesses is that there was none. Most certainly there were no lime wells to the west, to the south, to the north or to the east which could possibly have drained the premises involved. The only other wells are in the Southwest Quarter of Section 10, cornering said premises on the northeast, on which the closest lime well is over 1/4 mile away (R. 72a). But even though drainage were clearly established, under the authorities cited herein, there is no breach of the implied covenant to protect against drainage unless and until it is shown that the wells through which the drainage occurs produce oil in paying quantities

and are such wells as a reasonably prudent operator would offset.

Petitioners' Exhibit 1 shows that owners of leases adjoining the lease involved evidently have the same idea as respondent with respect to the practicability of further exploration. On the Southwest Quarter of Section 9, containing 160 acres, the Theta Oil Company has drilled only three wells, one a dry hole and the other two having an initial production of only 5 barrels. On the Southwest Quarter of said Section 9 no wells have been drilled. On the East Half of the Northwest Quarter of Section 16, containing 80 acres, the Syndicate Oil Company has drilled only one well, and that was dry. On the west half of said quarter section Parrish, *et al.*, have drilled only one well, with an initial production of only 5 barrels. On the Southeast Quarter of Section 8 no well has been drilled. On the Northeast Quarter of Section 17 the Skelly Oil Company has drilled no well. On the North Half of the Southwest Quarter of Section 16 the Florence Oil Company has drilled no well and said company has only drilled three wells on the Southwest Quarter of the Southwest Quarter of said section, one being a dry hole and the other two having an initial production of only 20 and 25 barrels, respectively. Only one well, with an initial production of 10 barrels, has been drilled on the Northwest Quarter of Section 21. And so on (R. 66a).

Conclusion.

The lease herein specifically provides that in the event the lessee discovers oil or gas in paying quantities, upon the leased premises, within ten years from the lease date, it shall continue in full force and effect, upon the whole of said premises—not any particular part thereof—as long thereafter as oil or gas, in paying quantities, is produced thereunder by the lessee. To limit the continuance of such a lease after discovery of oil or gas to any specific portion of the leased premises—whether the same be forty or a thousand acres—is to disregard plain and unequivocal language. No objection is made to the cancellation of such a lease where there has been a breach of either an express or an implied obligation of the lessee. Here it is not claimed that the respondent has violated any of its express obligations. The claim is that it has breached an implied obligation of its lease. And what is that implied obligation? Petitioners answer, the obligation to diligently and reasonably develop the leased premises. Well sounding words, but what do they mean? Certainly what is diligent and reasonable development does not depend solely upon lapse of time, or upon the amount of acreage covered by the particular lease, disregarding entirely the cost of the development, the prospects of discovering oil or gas, the cost of producing same, or the market therefor, to say nothing of other factors always considered by a reasonably prudent operator before deciding to commence a well. But that is exactly what the contention of petitioners reduces itself to,

and they would have the court believe that the Kansas decisions support them. Surely it cannot be said that the parties to an oil and gas lease ever contemplated that, notwithstanding the lessee had at great expense, discovered oil or gas in paying quantities and was producing same, he was required, in order to continue his lease as to the undeveloped portion of the leased premises, to keep drilling wells, in spite of the fact that there was no reasonable probability of discovering oil or gas therein, and in spite of the fact that no reasonably prudent operator would drill such wells. Instead of this being reasonable development it is the very opposite—unreasonable development. The implied obligation invoked by petitioners simply does not exist.

Respectfully submitted,

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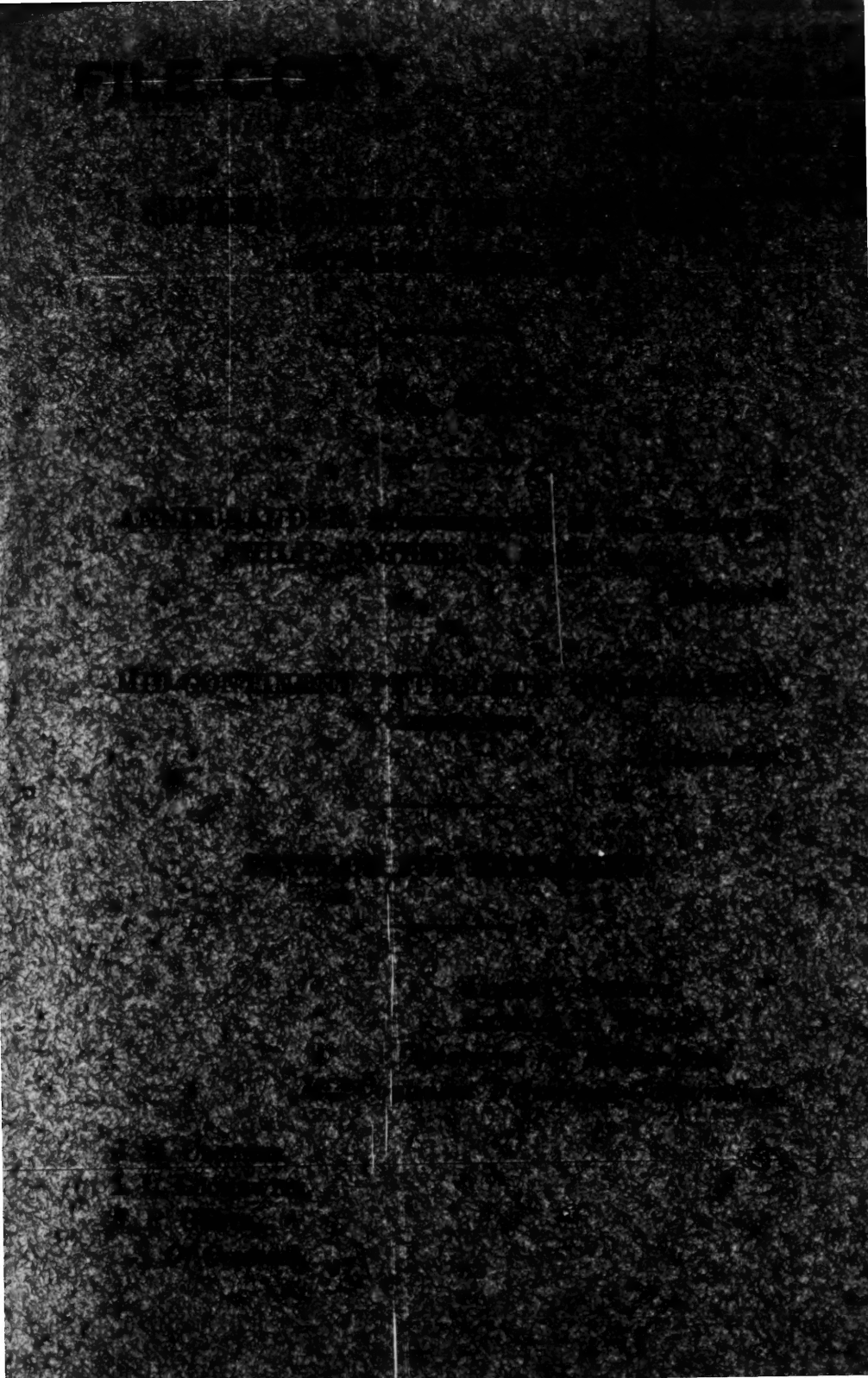

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 660

ANNIE SAUDER, ADMINISTRATRIX OF THE ESTATE OF PHILIP SAUDER, DECEASED, ET AL.,

Petitioners.

vs.

MID-CONTINENT PETROLEUM CORPORATION, A CORPORATION,

Respondent.

PETITION FOR REHEARING.

Petition for Rehearing.

Comes now the above named respondent, Mid-Continent Petroleum Corporation, and respectfully presents this, its petition for rehearing of the above entitled cause, and in support thereof respectfully shows:

Reasons for Filing This Petition.

Counsel most respectfully represent that the effect of the decision in this case will be so disastrous to the oil industry in Kansas, and that said opinion is so plainly erroneous that

their duty to their client as well as to the Court impels them to file this petition for rehearing.

Error of the Court.

In the opinion of counsel, the alleged error of the learned Court consists not in the statement of the controlling law, but in the obviously illogical and erroneous application thereof. Or, to state the point differently: after holding as a matter of law according to the long established rule laid down in *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, 810, 814, that respondent could not be required to drill a well that will not pay, the Court turns around and requires respondent to drill such a non-paying well.

Furthermore, the Court seems to have overlooked or ignored these controlling facts:

(1) That the term of respondent's oil and gas lease ran for "Ten Years from date hereof, and as long thereafter as Oil or Gas can be procured thereon in paying quantities, * * *" (Record page 6);

(2) That said lease further provides "if Oil or Gas be found on these premises by said second parties, all rights, benefits and obligations secured hereby shall continue so long as either can be procured in paying quantities" (Record page 7);

(3) That at all times subsequent to the drilling and completion of said two wells by respondent on the leased premises, said wells have continued to produce Oil in paying quantities (Record page 34);

(4) That this action is a suit in equity to cancel said lease, and that the burden was on petitioners to allege affirmatively and approve by a preponderance of the evidence that

respondent had breached some express or implied covenant of said lease;

(5) That under the rule of law laid down by the decision in *Brewster* v. *Lanyon Zinc Company, supra,* which is sustained by the opinion of the Court in this case, there was no obligation at law or in equity resting upon the respondent to drill an additional well on the leased premises, unless the respondent could drill a paying well, or unless a reasonably prudent operator would drill an additional well under the same or similar circumstances;

(6) That the petitioners in this case have wholly failed to allege the existence and breach of such a covenant, and have wholly failed to introduce any evidence tending to show a breach by respondent of any duty to drill an additional well; and that notwithstanding such failure of petitioners to allege affirmatively and prove by evidence that respondent has breached any express or implied covenant of the lease, the respondent has affirmatively shown by uncontradicted evidence that a paying well could not at this time be drilled on the leased premises, and that no reasonably prudent operator would at this time drill an additional well thereon.

Question Involved.

The question of law for decision is whether under respondent's lease and the evidence before the Trial Court there was any obligation to drill an additional well upon the lands involved. And this question is first, last and all the time dependent upon the question of fact whether or not it would have paid, or been profitable to, respondent, to drill another well. If it would have paid or been profitable there was an implied obligation to drill it. If it would not have paid, or been profitable there was no obligation to drill it.

The Applicable Law.

The Court in its opinion by Mr. Justice Roberts states the applicable law correctly. We quote the following from the opinion and only ask the Court to analyze and apply the same to the uncontradicted evidence, to-wit:

> "• • • With respect to a lease quite similar in its provisions it was said in *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, 810, 814:
>
> " 'The implication necessarily arising from these provisions—the intention which they obviously reflect—is that *if*, at the end of the five-year period prescribed for original exploration and development, oil and gas, one or both, had been found to exist in the demised premises in paying quantities, the work of exploration, development, and production should proceed with reasonable diligence *for the common benefit of the parties*, or the premises be surrendered to the lessor. (Italics ours.)
>
> " 'The object of the operations being to obtain a benefit or profit for *both lessor and lessee*, it seems obvious, in the absence of some stipulation to that effect, that *neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable.*' (Italics ours.)
>
> "After commenting on the fact that *the lessee is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result*, the Court adds: (Italics ours.)
>
> " 'Whether or not in any particuler instance such diligence is exercised depends upon a variety of circumstances, • • • *Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required.*' " (Italics ours.)

As before stated, the above is undoubtedly a true and correct exposition of the applicable law.

Application of the Above Law to the Uncontradicted Evidence.

With such a clear, concise and sound enunciation of the law it is incredible to us that the Court could have reached the conclusion that it did.

Bearing in mind that "the lessee is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result," which is but another way of saying that the lessee, after discovery by him of oil or gas in paying quantities, is not impliedly obligated to drill an additional well, when it would probably not pay so to do, we would call the earnest attention of the Court to the state of the record:

1. The petitioners introduced absolutely no evidence that there was any drainage by wells on adjoining lands.

2. The petitioners introduced absolutely no evidence that it would pay respondent to drill an additional well upon the lands involved.

3. The petitioners introduced absolutely no evidence that they could get any one to drill an additional well on said lands or that they themselves were willing to do so.

4. The petitioners introduced absolutely no evidence that they had been or would be able to sell a new lease to anyone.

Notwithstanding the above, and also notwithstanding the burden was upon the petitioners to allege and to prove by competent evidence that it would pay the respondent to drill an additional well on the lands involved, Summers Oil and Gas, pp. 434-435; (*Goodwin* v. *Standard Oil Co.*, 290 Fed. (8 C. C. A.) 92; *Orr* v. *Comar Oil Co.*, 46 Fed. (2d) (10 C. C. A.) 59; *Smith* v. *McGill, et al.*, 12 Fed. (2d) (8 C. C. A.) 32; *Cosden Oil Co.* v. *Scarborough*, 55 Fed. (2d)

(5 C. C. A.) 634, 639; and *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. (8 C. C. A.) 801), the respondent, as evidence of its good faith, established by the wholly uncontradicted evidence of three experienced oil men and one geologist: (1) that there was no drainage by wells on adjoining premises (2) that it would not pay the respondent to drill an additional well upon said premises; and (3) that no reasonably prudent operator would drill such well.

Mr. Justice Roberts, referring to the witnesses of respondent, who, by the way, were the only witnesses in the case, said: "These witnesses testified that in their judgment the geological formation, and the experience with wells drilled on nearby lands, made it so unlikely that oil would be obtained as to justify a prudent operator in abstaining from drilling additional wells on the Sauder tract."

Most certainly under this state of the record the Court has either failed to apply the law announced by it, or else has misapplied the same.

Mr. Justice Roberts, referring to the findings of the District Judge, said: "He summarized the evidence as to drilling on adjacent territory and found that there was *some probability that damage was being done to the leasehold through drainage by wells on adjoining properties. He was unable to decide the question of the likelihood that additional wells on the Sauder tract would produce oil or gas in paying quantities and held that in the state of the proofs nothing but exploration and positive tests by drilling could settle the controversy.*" (Italics ours.)

If the evidence was such that the District Judge was unable to decide therefrom whether it would pay to drill an additional well, it was his duty then to dismiss the petitioners' bill, because the burden was upon the petitioners to prove by competent evidence that it would probably pay to drill such well.

The statement of the Trial Judge that "nothing but exploration and positive tests by drilling" could determine whether or not an additional well would pay is merely a statement of what everyone with but a meagre familiarity with the oil and gas industry knows to be a fact. Likewise, no physican can guarantee a cure. Even lawyers are unable to conscientiously assure their clients victory. However, the experience of oil and gas operators and the scientific knowledge of geologists are such as to justify them in giving their opinions as to whether a paying well can be drilled at a particular location, and that is the best proof, if not the only proof, of which the matter is susceptible. *Howerton, et al.* v. *Kansas Natural Gas Co.*, 82 Kan. 367, 108 Pac. 813, 814, 815; *Julian Petroleum Corp.* v. *Courtney Petroleum Co.*, 22 Fed. (2d) (9 C. C. A.) 360, 362, 363. Certainly no judge, unless perchance he has the qualifications of a geologist or an experienced oil and gas operator, can say whether or not a given well would pay. And, if because the actual drilling of a well is the only way of absolutely determining whether or not it will pay, the lessee must actually drill and thus determine the matter, all of the decisions involving the instant question amount to nothing.

In *Cosden Oil Co.* v. *Scarborough*, 55 Fed. (2d) (5 C. C. A.) 634, 636, the court said: "Plaintiff pleaded, its testimony established, and the court found, that there was no way to tell in that territory whether oil and gas could be profitably produced *without drilling for it.* * * * Plaintiff offered no testimony of any person that a reasonably prudent operator, having in mind the interests of both lessor and lessee, would, in the exercise of due diligence," drill a well on the premises involved. And said court therefore held that the plaintiff's showing was wholly insufficient to justify a cancellation of the lease involved, or any part thereof.

With reference to the finding of the trial judge "that there was some probability that damage was being done to the leasehold through drainage by wells on adjoining properties," it is sufficient to say that there is absolutely no evidence to justify such finding and all of the evidence on the subject is emphatically to the contrary.

Mr. Justice Roberts seems to think that unless the petitioners are granted the relief prayed for the respondent will be able to hold its lease "for an indefinite period," without drilling any additional well. Such, however, is not the case, for when the lease ceases to produce oil in paying quantities—whether in one or twenty years—it by its own provisions terminates. And if in the future, before respondent's lease terminates, it would pay to drill an additional well or wells, respondent must drill the same, upon pain of cancellation of its lease.

The court, we think, reaches an erroneous conclusion with respect to the respondent's evidence to the effect that it had no *present intention* of drilling an additional well upon the premises involved. If, as the evidence clearly establishes, it would not pay to drill such well, the respondent, under the authorities, is justified in entertaining such intention and would probably be foolish to entertain any other. *This does not mean that in the future, and before its lease terminates, respondent will not drill an additional well or wells. If future events, regardless of what they might be, justify drilling same, it will do so; in fact, it will be required to.*

If it will not pay respondent to drill an additional well upon the premises involved, the mere lapse of time since the drilling of the last well, the amount of undeveloped acreage or the fact that respondent has no present intention of drilling an additional well affords no justification for cancelling its lease. To do so would nullify the lease—the solemn contract of the parties—which this Court has

no power to remake, in the absence of fraud, accident or mistake, because it provides emphatically that it shall continue, as to the whole of the leased premises, and not any particular part thereof, upon the discovery of oil or gas in paying quantities, as long thereafter as either can be produced in paying quantities, whether it be one or fifty years. *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. 801, 807, 808; *Fisher* v. *Crescent Oil Co.*, 178 S. W. (T. C. A.) 905, 906, 907; *McCallister, et al.* v. *Texas Co.*, 223 S. W. (Tex. Civ. App.) 859, 862, 863; *Duke* v. *Stewart*, 230 S. W. (Tex. Civ. App.) 485; *South Penn Oil Co.* v. *Snodgrass*, 76 S. E. 961, 963; and *Gypsy Oil Co.* v. *Cover, et al.*, 78 Okla. 158, 189 Pac. 540, 544. It is admitted that oil is being produced from said premises in paying quantities.

The court says that respondent "has held a half section for seventeen years without drilling of an exploratory well." The second well drilled by respondent upon the lands involved was drilled in January, 1922, and this suit was instituted June 27, 1930, and while it is an immaterial circumstance, the period of delay involved is approximately 8½ years. Furthermore, the primary term of the lease involved is ten years, which expired June 6, 1926, approximately four years before the commencement of this action, and during that ten years the lease did not require the lessee to drill any well, unless possibly in the case of the implied obligation to offset any paying well drilled on adjoining premises, provided the lessee paid the lessors an annual rental of $1.00 per acre. The first well was not drilled until November, 1921, approximately five years after the date of the lease, and presumably during this five years the lessors were paid the annual rental of $360.00.

None of the authorities cited in the court's opinion supports the conclusion reached herein. *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. 801, involved the consideration of a de-

murrer to the plaintiff's petition, and the Circuit Court of Appeals, at page 815, said : "The necessary inference from what is stated is that *further exploration and development would have been profitable to the lessee,* as well as beneficial to the lessor." Then the court, at page 820, concludes that "the lessor will be entitled to relief *only* in the event that the case made upon the hearing shall be, as is that made by the amended bill." In five of the nine cases cited in note 2 to Mr. Justice Roberts' opinion, *Becker* v. *Submarine Oil Co.,* 55 Cal. App. 698, 204 Pac. 245; *Goodwin* v. *Standard Oil Co.,* 290 Fed. 92; *Austin* v. *Ohio Fuel Oil Co.,* 218 Ky. 310, 291 S. W. 386; *Indiana Oil, Gas & Development Co.* v. *McCrory,* 42 Okl. 136, 140 Pax. 610; and *Phillips* v. *Hamilton,* 17 Wyo. 41, 95 Pac. 846, the courts refused to cancel the leases involved, either in whole or in part, and specifically held that unless it would pay the lessees to drill additional wells there was no breach of the implied obligation to further develop, regardless of the amount of acreage covered by the leases. In one of these five cases, *Becker* v. *Submarine Oil Co., more than nineteen years had elapsed since the drilling of the last well,* but the court held that this was not sufficient, in the absence of proof that it would have paid to drill additional wells, "to establish a lack of reasonable diligence." In one of the four cases in which the plaintiff prevailed, *Daughette* v. *Ohio Oil Co.,* 263 Ill. 518, 105 N. E. 308, the court found that the lessee could have profitably drilled other wells on the leased premises. In another one of said four cases, *Prince* v. *Standard Oil Co.,* 147 La. 283, 84 So. 657, the evidence failed to disclose whether it would pay to drill additional wells, for the lessee took the position that it was the sole arbiter as to the extent of development. However, in said case the court announced the doctrine that the lessee was not bound to drill wells which would be unprofitable to it, even though they would result in a benefit to the lessor. In another of said cases,

Texas Co. v. *Ramsower*, 7 S. W. (2d) (Tex.) 872, the lessee apparently made no contention that oil could not be discovered in paying quantities in additional wells. Said action was one for damages for drainage, and the lessee defended on the ground that delay rentals paid to the lessor justified it in failing to protect from drainage. The fourth case, *Jennings* v. *Southern Carbon Co.*, 73 W. Va. 215, 80 S. E. 368, was decided in favor of the lessor on a demurrer to his bill of complaint, which alleged that the lessee had fraudulently refused to drill an additional well and was fraudulently draining gas from under the leased premises through wells on adjoining premises. The demurrer admitted these allegations and the Appellate Court held that the demurrer should be overruled and the case sent back for trial. *In all of the aforesaid cases the courts clearly held that there is no breach of the implied obligation to further develop, save and except where it would pay to drill additional wells.*

All of the authorities clearly establish:

1. That during the primary term of a lease such as is involved herein, the lessee, if he pays the stipulated annual rental for the privilege of deferring the commencement of a well from year to year, cannot be required to drill any well, unless possibly a well offsetting one on adjoining premises. However, if the lessee would have this lease continue beyond the primary term, it is imperative that he discover oil or gas in paying quantities during such term.

2. That if, under a lease like the one involved, oil or gas is discovered in paying quantities during the primary term of the lease, then the lease provides, whether wisely or unwisely from the lessors' standpoint, that it shall continue in full force and effect as to all of the leased premises, and not any particular part thereof, as long as oil or gas is produced in paying quantities, whether it be one or fifty years.

3. That, of course, during the whole of the life of such a lease, the lessee must perform all of the express obligations contained therein, but there is no claim in the case at bar that the respondent has ever breached any of the express obligations of its lease.

4. That, upon the discovery of oil in paying quantities during the primary term of such a lease, the lessee is required to drill such additional wells, and only such additional wells, as a reasonably prudent operator would drill. However, to use the language of Mr. Justice Roberts, "he is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result," or, in other words, he is not required to drill any additional well, unless it would probably pay. This is the limit of the implied obligation sought to be applied in this case.

Therefore, as a matter of law, logic and equity, it follows that if, under such a lease as is involved herein, oil or gas is discovered in paying quantities during the primary term thereof, and the lessee violates none of the express obligations of his lease, and drills such additional wells as a reasonably prudent operator would drill, refusing, however, to drill any well or wells which would probably not pay, his lease continues as to the whole of the leased premises, and not any particular part thereof, as long as he is able to produce oil in paying quantities from the well or wells drilled by him, whether it be one or fifty years.

Applying the above to the case at bar:

1. Oil was discovered by the respondent in paying quantities during the primary term of its lease.

2. At all times subsequent thereto respondent has been and still is producing oil in paying quantities.

3. Respondent has breached none of the express obligations of its lease.

4. And, under the uncontradicted evidence and the rule announced by the opinion herein, the respondent has never to the present time been obligated to drill an additional well upon the leased premises, because all of the evidence is that no reasonably prudent operator would have drilled such well, and to require it to drill same would, under the uncontradicted evidence, be requiring it "to carry the operations on beyond the point where they will be profitable to him."

The error of the opinion of the court is particularly exemplified in its directions to the trial court to cancel the undeveloped portion of the involved lease, unless within a reasonable time respondent drills an additional well thereon, when, under the uncontradicted evidence before the court, no reasonably prudent operator would drill such well, and it would probably not pay so to do.

Probably the court is confused by the lapse of time since the drilling by respondent of its second well upon the premises involved, and the amount of undeveloped acreage, but under the rule of law announced by the court, all such questions as the lapse of time, the amount of undeveloped acreage, the number of wells drilled in the vicinity of a lease, their proximity to the lease, the amount of oil or gas produced therefrom, and whether such wells are draining oil or gas from under the leased premises, are merely incidental questions and cut no figure at all, save and unless they throw light upon or tend to solve the primary or ultimate question, namely, whether or not it would pay to drill an additional well. In other words, if it would not pay to drill an additional well, none of these incidental matters affords any justification whatsoever for the cancellation of the lease, for to do so would amount to scrapping the solemn contract of the parties. *The time element does not enter*

into the matter until it first becomes a fact that it would pay to drill an additional well, and then such well must be drilled within a reasonable time thereafter.

Speaking of the implied obligations to further develop, the court, in *Hall, et al.* v. *South Penn Oil Co. et al.*, 76 S. E. (W. Va.) 124, said:

> "The number and location of wells, requisite to the performance of this covenant, depend upon the character of the leased territory. *The area of the lease does not determine the number, nor is their relation to one another governed by any fixed rule.* Whether, after the discovery of oil or gas, by means of the initial or experimental well, there is a duty to sink additional wells, depends upon the probability, arising from the circumstances surrounding the property, that an additional well or wells will be profitable to the lessee. He is under no duty to operate it at a loss to himself to make the premises profitable to his lessor. It is only under circumstances indicative of mutual profit—profit to lessee as well as lessor—that the duty to operate devolves."

Many years of practice, devoted principally to the study and application of oil and gas law, convinces us that the views herein expressed are elementary to those familiar with the subject; and we most earnestly believe that this petition should be granted.

Respectfully submitted,

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Mid-Continent Petroleum Corporation.

J. H. CROCKER,
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J. P. GREVE,
Of Counsel.

CERTIFICATE OF COUNSEL.

We, James C. Denton and Richard H. Wills, attorneys for the respondent, Mid-Continent Petroleum Corporation, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

JAMES C. DENTON.
RICHARD H. WILLS.

(4994-C)

SUPREME COURT OF THE UNITED STATES.

No. 660.—October Term, 1933.

Annie Sauder, Administratrix, et al., Petitioners, *vs.* Mid-Continent Petroleum Corporation. On Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

[April 30, 1934.]

Mr. Justice Roberts delivered the opinion of the Court.

Philip Sauder, as owner of the E ½ of Sec. 16, Twp. 23, Range 13, Greenwood County, Kansas, and the SE ¼ of the SW ¼ of the same section, amounting in all to 360 acres, brought suit in a Kansas state court for the cancellation of an oil and gas lease. The cause was removed to the federal district court, where, after Sauder's death, it was revived in the right of his administratrix and heirs. The lease was made June 6, 1916; by sundry assignments the Petroleum Corporation had become the tenant. The recited consideration was $1.00 and the covenants and agreements on the part of the lessee. The term was ten years, and as long thereafter as oil and gas could be procured in paying quantities. The lessee was to deliver to the lessor one-eighth of the oil realized, and if gas should be found, $100 per year was to be paid for each gas well so long as its product was sold or marketed. If no well were commenced within one year all rights and obligations of the parties were to cease upon notice from the lessor to that effect, provided that the lessee should have the right to continue the lease in force from year to year until a well should be drilled, by paying an annual rental of $1.00 per acre. The instrument provided that the lessee might enter upon the premises for the purposes of the lease, use water from any creek or pond or drill for water to run machinery for prospecting and for operating the wells, should have the exclusive right to erect, lay and maintain pipe, machinery and structures necessary for producing, storing or transporting oil or gas. The contract ran in favor of and against the heirs, assigns, successors and personal representatives of the parties.

To offset two wells drilled on adjoining property, the lessee completed one well in November, 1921, and a second in January, 1922; but no other wells have been sunk, nor have any locations for wells been made. On the date of the expiration of the fixed term Sauder wrote the respondent stating that the lease had expired, and adding that he understood if it was a profitable contract respondent was supposed to operate, and if not, he understood the term had run out, and the respondent should release all the tract except the portion on which the wells were being operated. He asked what action the respondent proposed to take. The reply was that respondent considered it had a paying lease and would not surrender it.

The suit was instituted June 27, 1930. In addition to reciting the facts above outlined, the complaint asserted there had been development and production of oil on adjacent tracts, with consequent drainage of oil from the leased land; the respondent was bound to explore and develop the land and had neglected so to do; unless the lease were cancelled the respondent would continue to hold it for speculative purposes, and the plaintiffs be deprived of the objects and considerations for which the lease was made. The answer denied that the lease was being held for speculative purposes, denied the operations on surrounding tracts were causing drainage, alleged the drilling of the two wells was a fulfilment of the obligation to offset wells likely to drain from the demised premises, and denied any breach of the lease.

Upon the trial the petitioners offered in evidence a map showing the number of wells drilled on adjacent premises, the date when they came into production, and the amount of production from each, as well as the location of all which proved to be dry holes. The respondent offered expert testimony showing that in the vicinity there were two sands, the upper of which pinched out eastward of the demised premises, and that the wells on the latter and those on lands to the west and south thereof were in the lower sand, known as the Mississippi lime. These witnesses testified that in their judgment the geological formation, and the experience with wells drilled on nearby lands, made it so unlikely that oil would be obtained as to justify a prudent operator in abstaining from drilling additional wells on the Sauder tract.

The district judge found that the two wells were drilled as offsets and had been producing oil in small but paying quantities. He summarized the evidence as to drilling on adjacent territory,

and found that there was some probability that damage was being done to the leasehold through drainage by wells on adjoining properties. He was unable to decide the question of the likelihood that additional wells on the Sauder tract would produce oil or gas in paying quantities, and held that in the state of the proofs nothing but exploration and positive test by drilling could settle the controversy. After referring to the notice sent by Sauder to the respondent at the termination of the ten year period, he found that no effort had thereafter been made toward exploration or development by drilling wells or otherwise, and that the respondent and its officers had no present intention of further exploring and developing, unless and until developments in the immediate vicinity should convince them that it would pay to take such action. The conclusion was that petitioners had no adequate remedy at law, the respondent and its predecessors in title had not in good faith and with reasonable diligence explored and developed the lands as required by the express and implied covenants of the lease; that it would be inequitable to permit the respondent to hold the property without further exploration and development, as it proposed to do; and that the petitioners were entitled to a decree cancelling the lease, except as to a portion of the SE ¼ of the SW ¼ of Sec. 16 (upon which the two off-set wells were drilled), as to which the respondent may hold and enjoy its leasehold right so long as it produces gas or oil therefrom in paying quantities. A decree was entered in accordance with the findings, adding the qualification that as to tanks, pipes and equipment located somewhat north of the acreage which the respondent was permitted to retain, these need not be moved until they should become obstacles to the development of the petitioners' land.

Upon appeal, the Circuit Court of Appeals (one judge dissenting) reversed the decree, holding that the respondent had not violated the covenants of its lease, and until it should be guilty of a breach it was entitled to continue to hold the whole tract. The reversal was without prejudice to the bringing of a new suit in the event changed conditions should indicate a breach of respondent's implied covenant to develop. We brought the case here by writ of certiorari.

The question for decision is whether the respondent failed to comply with an implied covenant to develop the tract with reasonable diligence. The petitioners' position is that since the lease

was of land in Kansas the case is to be decided according to the rule of law adopted by the Supreme Court of the State, which is said to be more stringent as respects the lessee's obligation than that generally applied by state and federal courts. The majority of the Court of Appeals were of opinion that at the date of the making of the lease the law of the State, as evidenced by the decisions of its Supreme Court, was the same as that followed by the federal courts; and if, by decisions announced subsequent to the effective date of the lease, a broader rule was laid down, the federal courts ought not to apply it with retroactive effect. The petitioners assert that the court was in error in both conclusions.

It is unnecessary to inquire as to the law of Kansas, or the effect to be given it in this case, since we think that the rule followed generally requires a reversal of the decree dismissing the bill.

It is conceded that a covenant on respondent's part to continue the work of exploration, development and production is to be implied from the relation of the parties and the object of the lease; and that this covenant was not abrogated by the expiration of the primary term of ten years.[1] The matter in dispute is the respondent's alleged failure to comply with its obligation. The petitioners say that if the lessee with good reason believes there is no mineral to be obtained by further drilling it should give up the lease; the respondent insists that as there is only a possibility of finding mineral, no prudent operator would presently develop, but the mere possibility entitles it to hold the lease, because it is producing oil from a portion of the area.

We think the respondent's contention cannot be sustained. With respect to a lease quite similar in its provisions it was said in *Brewster* v. *Lanyon Zinc Company*, 140 Fed. 801, 810, 814:

"The implication necessarily arising from these provisions—the intention which they obviously reflect—is that if, at the end of the five-year period prescribed for original exploration and development, oil and gas, one or both, had been found to exist in the

[1] *Allegheny Oil Co.* v. *Snyder*, 106 Fed. 764; *Brewster* v. *Lanyon Zinc Co.*, 140 Fed. 801; *Acme Oil & Mining Co.* v. *Williams*, 140 Cal. 681; *Daughetee* v. *Ohio Oil Co.*, 263 Ill. 518; *Gadbury* v. *Ohio & Indiana Consol. Nat. & Ill. Gas Co.*, 162 Ind. 9; *Dinsmoor* v. *Combs*, 177 Ky. 740; *Harris* v. *The Ohio Oil Co.*, 57 Oh. St. 118; *Indiana Oil, Gas & Development Co.* v. *McCrory*, 42 Okl. 136; *Kleppner* v. *Lemon*, 176 Pa. 502; *J. M. Guffey Petrol. Co.* v. *Jeff Chaison Townsite Co.*, 48 Tex. Civ. App. 555; *Hall* v. *South Penn Oil Co.*, 71 W. Va. 82; *Phillips* v. *Hamilton*, 17 Wyo. 41.

demised premises in paying quantities, the work of exploration, development, and production should proceed with reasonable diligence for the common benefit of the parties, or the premises be surrendered to the lessor.

"The object of the operations being to obtain a benefit or profit for both lessor and lessee, it seems obvious, in the absence of some stipulation to that effect, that neither is made the arbiter of the extent to which or the diligence with which the operations shall proceed, and that both are bound by the standard of what is reasonable."

After commenting on the fact that the lessee is not required to carry the operations on beyond the point where they will be profitable to him, even though some benefit to the lessor will result, the court adds:

"Whether or not in any particular instance such diligence is exercised depends upon a variety of circumstances, . . . Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required."

This definition of the scope of the implied covenant has been generally adopted in decisions of federal and state courts.[2] The facts demonstrate that the respondent has not complied with its obligations. It has held a half section for seventeen years without the drilling of an exploratory well, and claims to be entitled to hold the lease for an indefinite period with no exploration unless some other operator brings in a producing well on adjoining land, or fresh geological data comes to light. The two producing wells are on the forty acres comprising the smaller of the adjacent areas embraced in the lease. The justification for the respondent's position is that the geologic data and the experience upon surrounding lands are both unfavorable to the discovery of oil or gas upon the east half of section 16 (the 320 acre tract). The respondent's officers state that they desire to hold this tract because it may contain oil; but they assert that they have no present intention of drilling at any time in the near or remote future. This attitude does not comport with the obligation to prosecute development with due

[2]*Goodwin* v. *Standard Oil Co.*, 290 Fed. 92; *Becker* v. *Submarine Oil Co.*, 55 Cal. App. 698; *Daughetee* v. *Ohio Oil Co.*, 263 Ill. 518; *Austin* v. *Ohio Fuel Oil Co.*, 218 Ky. 310; *Prince* v. *Standard Oil Co.*, 147 La. 283; *Indiana Oil, Gas & Development Co.* v. *McCrory*, 42 Okl. 136; *Texas Co.* v. *Ramsower*, (Tex.) 7 S. W. (2d) 872; *Jennings* v. *Southern Carbon Co.*, 73 W. Va. 215; *Phillips* v. *Hamilton*, 17 Wyo. 41.

regard to the interests of the lessor. The production of oil on a small portion of the leased tract cannot justify the lessee's holding the balance indefinitely and depriving the lessor not only of the expected royalty from production pursuant to the lease, but of the privilege of making some other arrangement for availing himself of the mineral content of the land.

The decisions[3] on which the Circuit Court of Appeals relied recognize and apply the rule of *Brewster* v. *Lanyon Zinc Company, supra,* but are distinguishable because of a difference in the circumstances in which the rule was applied. Some of them involved the duty to drill wells to offset others brought into production on adjoining lands; others turned upon a waiver by the lessor of the lessee's obligation to explore, or the meaning of the phrase "so long as oil or gas is produced in paying quantities". In none of them was there a neglect to explore or develop for any such period as is here shown, or an expressed intention not to do so, in a comparable situation.

The petitioners are entitled to relief in equity as they have no adequate remedy at law. *Brewster* v. *Lanyon Zinc Company, supra,* pp. 818-819; *Guffey* v. *Smith,* 237 U. S. 101, 114. The District Court decreed a cancellation as to all except a strip four hundred feet wide along the southern boundary of the SE ¼ of the SW ¼ of Section 16, containing about eight acres. The dissenting judge in the court of appeals thought that a decree should be entered cancelling the lease as to the 320 acre tract (the E ½ of the Section) unless within a reasonable time an exploratory well should be drilled therein to the Mississippi lime, and that the 40 acres embraced in the SE ¼ of the SW ¼ of Section 16 should remain under the lease. We are of opinion that such a decree would recognize and protect the equities of both parties.

The judgment is reversed and the cause remanded to the District Court for further proceedings in conformity with this opinion.

So ordered.

Mr. Justice STONE took no part in the consideration or decision of this case.

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[3] *Goodwin* v. *Standard Oil Company of Louisiana,* 290 Fed. 92; *Humphreys Oil Company* v. *Tatum,* 26 F. (2d) 882; *Orr* v. *Comar Oil Company,* 46 F. (2d) 59; *Denker* v. *Mid-Continent Petroleum Corporation,* 56 F. (2d) 725; *Pelham Petroleum Company* v. *North,* 78 Okl. 39; *Broswood Oil & Gas Company* v. *Mary Oil & Gas Company,* (Okl.) 23 P. (2d) 387.